

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

-----X  
In Re: : 05-60006  
REFCO, LLC, :  
Debtor. :  
-----X  
AXIS REINSURANCE COMPANY, : 07-1712  
Plaintiff, :  
v. : One Bowling Green  
BENNETT, et al., : New York, New York  
Defendants. : August 30, 2007  
-----X

TRANSCRIPT OF HEARING ON MOTIONS  
BEFORE THE HONORABLE ROBERT D. DRAIN  
UNITED STATES BANKRUPTCY JUDGE

APPEARANCES:

For Klejna/Murphy: MATTHEW R. GOLDMAN, ESQ.  
HELEN B. KIM, ESQ.  
Baker & Hostetler LLP  
3200 National City Center  
1900 East 9th Street  
Cleveland, Ohio 44114-3485

For Director Defendants: MICHAEL F. WALSH, ESQ.  
SCOTT E. COHEN, ESQ.  
Weil, Gotshal & Manges LLP  
767 Fifth Avenue  
New York, New York 10153-0119

For Axis Reinsurance: JOAN M. GILBRIDE, ESQ.  
WAYNE BERGEEST, ESQ.  
ROBERT A. BENJAMIN, ESQ.  
Kaufman, Borgeest & Ryan LLP  
200 Summit Lane Drive  
Valhalla, New York 10595

(Appearances continue on next page.)

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

APPEARANCES CONTINUED:

For Defendants Schoen,      PAUL FERRILLO, ESQ.  
    Jaekel Lee, Harkins,      Weil, Gotshal & Manges LLP  
    Brightman, O'Kelly      767 Fifth Avenue  
    and Gantscher:      New York, New York 10153-0119

For Phillip Silverman:      RICHARD CASHMAN, ESQ.  
                                 Times Square Tower  
                                 7 Times Square  
                                 New York, New York 10036-6524

For Tone Grant:      NORMAN L. EISEN, ESQ.  
                                 Zuckerman Spaeder LLP  
                                 1800 M Street NW, Suite 1000  
                                 Washington, D.C. 20036-5802

For Phillip Bennett:      DEBORAH ADLER, ESQ.  
                                 Golenbock, Eiseman, Assor,  
                                 Bell & Peskoe LLP  
                                 457 Madison Avenue  
                                 New York, New York 10022

For Arch Insurance:      DANIEL STANDISH, ESQ.  
                                 Wiley Rein LLP  
                                 1776 K Street NW  
                                 Washington, D.C. 20006

For Robert Trosten:      RACHEL M. KORENBLAT, ESQ.  
                                 Morvillo, Abramowitz, Grand,  
                                 Jason, Anello & Bohren, PC  
                                 565 Fifth Avenue  
                                 New York, New York 10017

(Appearances continue on next page.)

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

APPEARANCES CONTINUED:

For Sexton and Sherer: IVAN O. KLINE, ESQ.  
Friedman & Wittenstein  
600 Lexington Avenue  
New York, New York 10022

Court Transcriber: RUTH ANN HAGER  
TypeWrite Word Processing Service  
356 Eltingville Boulevard  
Staten Island, New York 10312

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transcript produced by transcription service

1 (Proceedings began at 10:20 a.m.)

2 THE COURT: Okay. Refco and the Axis Reinsurance  
3 matters.

4 [Pause in the proceedings.]

5 MR. GOLDMAN: Good morning, Your Honor.

6 THE COURT: All right. There are a number of  
7 matters on that generally come under the heading of the Axis  
8 Reinsurance matters.

9 Have the parties discussed any particular order  
10 that they want to proceed in?

11 MR. GOLDMAN: Good morning, Your Honor. Matthew  
12 Goldman, Baker & Hostetler. I will be speaking on behalf of  
13 what we have called the moving defendants, the parties seeking  
14 a preliminary injunction for advancement of defense costs.

15 Yes, I have spoken with Joan Gilbride -- yeah. I  
16 have spoken with Joan Gilbride. I believe at least insofar as  
17 Axis and the other moving defendants are concerned, the  
18 appropriate procedure would be that this Court first determine  
19 whether or not Arch should be permitted to intervene so that we  
20 can determine whether or not they would be heard.

21 THE COURT: Right. I agree with you.

22 MR. GOLDMAN: Our suggestion --

23 THE COURT: I'd go with that first.

24 MR. GOLDMAN: Okay. Thank you, Your Honor. Then  
25 our suggestion would be that we proceed with the motion to

1 advance defense costs, the motion to file by the motions to  
2 dismiss or to stay. And insofar as the lift stay motions are  
3 concerned, there is no objection to lifting the stay to the  
4 extent that it is applicable to deal with the defense cost  
5 issues. That's not in dispute at all. The only thing that is  
6 potentially at issue in the lift stays in my supplemental  
7 motion asking for permission to also enter into settlements.  
8 We can put that at the end because nothing about the lift stay  
9 interferes with this argument.

10 THE COURT: Okay. I appreciate that probably a  
11 fair amount of thought went into that order of proceeding and  
12 perhaps some tactical considerations, too, but it strikes me  
13 given the lack of any opposition, except the limited amount to  
14 the part of the lift stay motion that it ought to be be lifted  
15 for all purposes, that I should hear the motion to dismiss  
16 first and then deal with the issue of advancing defense costs,  
17 particularly since the debtor doesn't seem to care about that  
18 and it appears to be no dispute because they haven't taken any  
19 position whatsoever on this and they've not opposed lifting the  
20 stay.

21 MR. GOLDMAN: Your Honor, I didn't actually say  
22 it's that material in that order.

23 THE COURT: Okay.

24 MR. GOLDMAN: So, yeah, if the Court wishes to do  
25 dismissal first, that is fine with us, Your Honor.

1 THE COURT: Okay. That's fine.

2 MR. GOLDMAN: All right. So I think then that  
3 means that we start with intervention?

4 THE COURT: So I need to hear from Arch, then,  
5 first.

6 MR. GOLDMAN: Thank you, Your Honor.

7 MR. STANDISH: Good morning, Your Honor. Daniel  
8 Standish of Wiley Rein on behalf of Arch Insurance Company.

9 Your Honor, we seek to intervene in this case for  
10 the limited purpose of opposing the request for the advancement  
11 of defense costs notwithstanding the existence of a coverage  
12 defense that bars coverage for the claim in its entirety.

13 Arch is in the same tower of insurance as Axis.  
14 Arch has the policy that is ten million dollars excess of 40  
15 million dollars. At this point, the underlying limits have  
16 been depleting rapidly. We understand that the burn rate at  
17 this juncture is about two million dollars a month.

18 The demand is that the officer defendants in this  
19 case have made that Axis pay for their defense fees and costs  
20 on an as-incurred basis notwithstanding the existence of a  
21 threshold defense. That is an issue that will affect Arch, as  
22 well, in two different ways. One, it will affect the amount of  
23 the policy limits that remain under the Arch layer, as well as  
24 affect Arch's rights potentially as a precedential matter if and  
25 when Arch's policy is reached, which at this point given the

1 burn rate at least the amounts incurred would certainly  
2 implicate that level. So for that reason, Arch has a very  
3 strong interest of that particular issue.

4 Arch also feels strongly about intervening in this  
5 case because as Your Honor may recall in June of 2006 Your  
6 Honor gave leave for Arch to file its declaratory judgment  
7 action in New York Supreme Court in order to obtain an  
8 adjudication of the coverage issues. Your Honor found that  
9 Arch would be prejudiced if it were unable to do so.

10 Once we got before Justice Freedman, the officer  
11 defendants who are now demanding that Axis advance defense fees  
12 and costs argued to Justice Freedman that the Arch suit should  
13 be dismissed without prejudice, because it was totally  
14 speculative whether or not the erosion of the underlying layers  
15 would ever occur and Arch's policy would be implicated. And  
16 even if it did implicate Arch's layer, Arch could simply stand  
17 on its denial and refuse to pay, thus directly contrary to the  
18 position that they've now taken before this court in demanding  
19 advancement.

20 So for that reason, we feel that Arch's interest --

21 THE COURT: That wasn't the only reason they  
22 opposed it, right?

23 MR. STANDISH: That was not the only reason.  
24 That's correct, Your Honor. There was also an argument that it  
25 would overlap with the underlying facts at issue in the

1 criminal prosecution going forward.

2 But Justice Freedman specifically did not reach  
3 the issue of whether or not the insurers could be obligated to  
4 include advance defense fees and costs notwithstanding the  
5 existence of a threshold coverage defense.

6 Arch has moved promptly to intervene, Your Honor.  
7 We've briefed this contemporaneously. We filed with our  
8 intervention papers our opposition to the request for  
9 advancement and we don't feel that any of the defendants would  
10 be prejudiced by the intervention. In fact, it would be far  
11 more efficient to adjudicate this issue in the context of the  
12 same proceeding than have it litigated again at some future  
13 juncture against Arch in a separate pleading.

14 So for that reason, Your Honor, we submit that  
15 permissive intervention is appropriate here and should be, Arch  
16 should be permitted to be in for this purpose.

17 THE COURT: But it's not necessarily the same  
18 issue, is it?

19 MR. STANDISH: With respect to the primary policy  
20 language it is, Your Honor. Both the Axis policy and the Arch  
21 policy incorporate by reference the language on which the  
22 officers are relying for the advancement of defense fees and  
23 costs. They're focusing in the primary policy in condition (d)  
24 that says that the insurer shall advance the covered advanced  
25 costs on an as-incurred basis. The dispute over whether or not



1 the advancement of covered advanced costs is required when the  
2 policy excludes the defense costs is the same issue as to both  
3 Axis and Arch.

4 The only distinction is in the policy provisions  
5 on which Arch and Axis are relying for the denial of coverage.  
6 Arch has its own prior knowledge exclusion in its policy and  
7 there is no dispute in that case that that exclusion exists and  
8 that it applies. There's a dispute in the Axis case over  
9 whether or not the exclusion actually is in the policy. Axis  
10 obviously takes the position that it is, but that dispute  
11 doesn't exist as to Arch.

12 But with respect to the primary policy language,  
13 the question of whether advancement of "covered defense costs"  
14 means you have to advance uncovered defense costs is precisely  
15 the same.

16 THE COURT: Okay.

17 MR. STANDISH: Thank you, Your Honor.

18 MR. KLINE: Good morning, Your Honor. Ivan Kline  
19 from Friedman & Wittenstein in New York.

20 We represent in this action two of the officer  
21 defendants, William Sexton and Sherer, arguing against the  
22 intervention on behalf of them as well as defendants Klejna,  
23 Murphy and Silverman, who are the five sort of moving insureds  
24 on the advancement motion.

25 And even assuming there is some common question of

1 law, this is clearly a case where the Court should exercise its  
2 discretion to deny the motion. This case is about coverage  
3 under the Axis policy, not the Arch policy. We've asserted a  
4 counterclaim against Axis; under the Axis policy we have not.  
5 They are not mentioned or in any way involved the Arch policies  
6 and we've made an advancement motion solely as against Axis  
7 because its policy is now the one that's up, so to speak.

8           We have no claims against Arch. We haven't asked  
9 for advancement against Arch. Arch wants to litigate not just  
10 advancement in the abstract. It specifically says it wants to  
11 intervene to litigate whether the Arch policy requires Arch to  
12 advance defense costs, but nobody's made that request, so I  
13 don't know against whom they're going to litigate that, because  
14 we haven't made the motion. So procedurally there is a flaw in  
15 what they seek to do, because nobody is seeking relief against  
16 Arch, so they can't really be heard on an issue of when their  
17 policy requires advancement of defense costs. In fact, they  
18 rely very clearly on a specific provision of their policy,  
19 which we have not briefed, we have not addressed because we  
20 have no claims against them.

21           There's also a procedural flaw which their own  
22 proposed opposition brief sets out and that they didn't address  
23 in their reply when we pointed it out. They state in their  
24 proposed brief and in opposing advancement that in order for  
25 there to be an advancement motion, there has to be an

1 underlying claim to support the request for relief, which  
2 advancement would go with. For example, the five moving  
3 insureds have counterclaims against Axis and it's those  
4 counterclaims with declaratory injunctive relief that support  
5 our request for advancement.

6 Arch points that out because it says others aren't  
7 really empowered to advancement anyway, but then it still seeks  
8 to adjudicate advancement under its policy just by itself  
9 without being hooked on in any way to any claim by or against  
10 it. And it's created its own procedural conundrum. It  
11 recognized it can't come in here to seek to intervene and  
12 litigate coverage under the policy, because that would be  
13 barred by Justice Freedman's order. So instead they're seeking  
14 just to litigate this advancement issue, but you can't really  
15 litigate that in the abstract by itself without the "coverage"  
16 under the policy also being in dispute. They themselves state  
17 that in their proposed opposition brief.

18 In terms of the other procedural flaw would be if  
19 Your Honor granted that intervention, you know, then what? We  
20 haven't made a motion against Arch, so how can Your Honor  
21 adjudicate whether advancement is required under the Arch  
22 policy when we haven't briefed it, and we have no intention at  
23 this point of briefing it, and may never have to brief it.

24 And in terms of judicial efficiency, some court is  
25 going to have the coverage dispute against Arch unless it, you

1 know, goes away due to one cause or another. It's not going to  
2 be this court, because by their own statement they can't come in  
3 here now to seek to adjudicate coverage. So to have this court  
4 somehow rule in the abstract on advancement under the Arch  
5 policy simply makes no sense when some other court will have  
6 the coverage issue. And in both cases they're going to be  
7 raising the prior knowledge exclusion in their policy as the  
8 key provision to look at.

9 Now, clearly for purposes of efficiency, if we  
10 ever want to seek advancement under the Arch policy, we'll have  
11 to do something. We'll have to do it in some court where  
12 coverage is also at issue. And in terms of what Arch's counsel  
13 said we're already inconsistent positions, advancement was not  
14 an issue before this.

15 THE COURT: Oh, you don't have to get into that  
16 one.

17 MR. KLINE: All right. I think that covers the  
18 points I want to make, unless Your Honor has some further  
19 questions.

20 THE COURT: Okay. Why isn't counsel right that, as  
21 you said, the common issue here is coverage under the primary  
22 policy and coverage was raised in state court so why isn't this  
23 really an end run around the state court decision?

24 MR. KLINE: There are different coverage issues.  
25 This coverage issue is not reached by Justice Freedman. At

1 pages 3 to 4 of the rule --

2 THE COURT: But she said it was premature and this  
3 shouldn't be happening now.

4 MR. KLINE: She found that the litigation of the  
5 application of the Arch exclusion was premature. What Justice  
6 Freedman did not reach was the question that is being presented  
7 by the motion for preliminary injunction to be argued this  
8 morning of whether or not under language of the primary policy  
9 and applicable law an insurance company that has denied,  
10 regardless of the basis, can't -- has to be obligated to advance  
11 defense fees and costs notwithstanding the existence of that  
12 coverage defense when the demand is made and has to instead  
13 litigate issues of coverage all the way to a conclusion and  
14 then try to recoup those amounts.

15 That limited question is the question on which  
16 Arch seeks to intervene here, and that's the question that's  
17 presented by the motion for preliminary judgment. Regardless  
18 of what the specific coverage defense is, the common issue is  
19 whether or not given the language of the primary policy that  
20 only requires the advancement of covered defense costs, the  
21 Court should turn a blind eye to that language and enforce the  
22 advancement of those defense fees and costs anyway until there's  
23 some final adjudication in the coverage litigation.

24 THE COURT: But I mean, you're using the same term,  
25 "covered," "coverage." It's the same term and it's the same

1 analysis, isn't it, that she went through?

2 MR. KLINE: No, Your Honor. The analysis --

3 THE COURT: I mean, I understand that she had an  
4 alternative basis for her ruling, so one of her bases -- we  
5 went through this point on coverage.

6 MR. KLINE: Your Honor, Justice Freedman did not  
7 look at the advancement language in the policy. In the Supreme  
8 Court, the director defendants actually asked Justice Freedman  
9 to enter an order for the advancement of defense fees and costs  
10 until final adjudication of the coverage issue. And in her  
11 opinion she expressly did not reach that issue, so the specific  
12 issue on which we seek to intervene in this matter were reached  
13 by Justice Freedman.

14 THE COURT: They're not asking for it here.

15 MR. KLINE: They are, Your Honor, in their  
16 preliminary injunction papers.

17 THE COURT: Not from Arch.

18 MR. KLINE: They are asking it from Axis and it  
19 will be the same issue under the primary policy language  
20 because both Arch and Axis incorporate by reference conditions  
21 D-2 and D-3, which are at issue in this case.

22 Because of that overlap Arch has an interest in  
23 the income. I have no doubt that depending on the outcome here  
24 one side or the other will be able to tout that, if and when  
25 the Arch layer is ever reached. And, given the burn rate on

1 defense expenses and the demands for settlement that are now  
2 being bandied about, I have no doubt that the existence of  
3 coverage under the Arch policy will be squarely at issue in the  
4 very near future based on the communications that we're  
5 receiving. And at that point, we're going to have to deal with  
6 this issue. It's much more efficient to deal with the issue in  
7 one proceeding when that same language is at issue on that  
8 issue.

9 THE COURT: Even though you have different  
10 language in your own policy from --

11 MR. KLINE: The exclusionary language differs.  
12 That's correct, Your Honor.

13 THE COURT: Okay.

14 MR. STANDISH: Your Honor, I just want to  
15 reiterate. Their motion very clearly says they seek to  
16 intervene to litigate the issue whether the Arch policy  
17 requires Arch to advance defense costs. They're not coming in  
18 seeking to just talk about whether in general we can get  
19 advancement or whether under the Axis policy we're entitled to  
20 advancement and question whether they even have standing to do  
21 that.

22 In that sense, they're like any insurer that may be  
23 out there that may have language similar to the primary policy  
24 in any case. You wouldn't allow that insurer to come and  
25 intervene in this case. And here, they've already been told by

1 Justice Freedman they really can't do what they're now seeking  
2 to do. And if you look at their proposed brief, it's full of  
3 references that their policy, their prior knowledge to  
4 exclusion: they're seeking to argue the applicability of that  
5 exclusion albeit to try to avoid advancement as against them,  
6 which has not been sought.

7 THE COURT: Okay. Arch Insurance Company has  
8 moved for permission to intervene under Rule 24(b) incorporated  
9 by Bankruptcy Rule 7024 in this declaratory judgment litigation  
10 between a lower tier insurer, Axis Reinsurance Company and  
11 various defendants, former directors and officers of Refco,  
12 Inc. The movant acknowledges that there's not a complete  
13 overlap of the issues in the Axis Reinsurance litigation and  
14 the litigation that it would want to pursue if it were  
15 permitted to intervene, which would be to seek a declaratory  
16 judgment that it -- that is, Arch -- would not be obligated  
17 under the Arch policy to advance defense costs to the directors  
18 and officer beneficiaries of Refco's insurance with it. That is  
19 because exclusions relied upon by Arch in its policy differ  
20 from exclusions relied upon by Axis.

21 The common issue that Arch relies upon for  
22 purposes of Rule 24(b) is language in the first-tier policy  
23 pertaining to covered claims as they relate to defense costs,  
24 among others -- or "losses," as defined in the policy -- which  
25 is a link in the logical chain that if broken might prevent



1 Arch from pursuing certain of its arguments, if not all of  
2 them, that it does not have to advance coverage. No  
3 beneficiary of the policy has actually apparently at this time  
4 sought to compel Arch to advance coverage. I would also note  
5 that the debtor in this case has appeared to be completely  
6 neutral on the issue and is not a party to this litigation and  
7 has taken no position whatsoever.

8           It appears to me that to the extent that it is a  
9 common issue of law (and fact to the extent there's any factual  
10 issue) in interpreting the relevant insurance policies, it  
11 would not be a proper exercise of my discretion to permit Arch  
12 to intervene. As is clear from the briefing on the motions  
13 before the Court today in connection with the Axis Reinsurance  
14 matter, first, the actual language of the policy is important.

15       Second, issues of ripeness or whether the Axis litigation is  
16 premature are important and are to some extent fact driven, in  
17 particular driven by the claimed exigencies faced by the policy  
18 beneficiaries, the officers and officers who have felt the  
19 pinch of not getting the coverage at that tier.

20           To my mind, it would therefore be inefficient to  
21 include Arch in this litigation at this time, and it would  
22 instead be efficient to pursue the issues that are truly before  
23 the Court in this litigation: that is, the issues involving  
24 Axis and the directors and officers' claims against Axis and not  
25 use this litigation as a funnel to invite any prospective

1 insurer to join some sort of massive proceeding.

2 That's compounded by two other considerations.

3 First, I note that Arch pursued in New York State court  
4 declaratory judgment litigation regarding the terms of its own  
5 policy and "coverage" under that policy, and the state court  
6 ruled that that litigation was premature. It seems to me, in  
7 large extent this is an end run around that ruling -- that,  
8 i.e., Arch's request to intervene here would be an end run  
9 around that ruling -- and at a minimum that if I permitted Arch  
10 to intervene, we would be frequently interrupted in litigation  
11 by considerations of whether what Arch is in particular seeking  
12 at that particular moment (if I permitted it to intervene)  
13 would be an end run around that order or whether the order  
14 would be binding on it.

15 Finally, as I noted at the pretrial conference on  
16 this matter, I continue to have some concern, given (a) that  
17 Refco's plan is confirmed and effective and substantially  
18 consummated and (b) that Refco, the debtor, has no  
19 participation in this litigation at all, as to the extent of my  
20 jurisdiction over it. And in light of all the other factors  
21 that I've already mentioned arguing that I should not exercise  
22 my discretion to further expand this adversary proceeding to  
23 involve other insurers, it seems to me that Arch's issues, if  
24 they're to be brought at all, should be brought in another court  
25 when they become ripe.

1                   So I'm not sure which of these counsel here took  
2 the lead on this matter, but certainly you could submit an  
3 order consistent with my ruling denying the motion.

4                   I would ask you just to send a -- well, you can  
5 work it out among yourselves. I'd just ask one of you to send a  
6 copy to Arch's counsel. You don't have to settle it on him, but  
7 just send him a copy at the same time you're sending it to  
8 chambers, or as a courtesy you may want to send it to him a day  
9 before, so he can determine that it's consistent with my ruling.

10

11                   MR. KLINE: Okay. No problem.

12                   THE COURT: Okay. Okay. All right. So that  
13 leads to the motion to dismiss.

14                   [Pause in the proceedings.]

15                   MR. WALSH: Michael Walsh from Weil, Gotshal &  
16 Manges on behalf of all of what we call the director  
17 defendants. That's Brightman, Ganter, Harkins, Jeakel, Lee,  
18 O'Kelly and Schoen. It seems like Your Honor is very familiar  
19 with the background here, but I can just run through the  
20 structure if that would be helpful.

21                   THE COURT: Okay.

22                   MR. WALSH: Refco arranged the known insurance in  
23 the amount of 70 million dollars. That consists of a primary  
24 policy and five excess policies. Axis provides a third tier in  
25 that tower, that is, the second excess policy and all of the

1 excess policies follow the form of the primary policy, except  
2 to the extent that they're explicitly different. This means  
3 that the excess insurers are actually bound by the terms of the  
4 primary policy. The language that's key to today's dispute both  
5 in connection with the motion to dismiss and the motions to  
6 compel advancement is the language in the primary policy that  
7 requires the advancement of defense costs as they're incurred  
8 and unless it is finally determined that such costs are not  
9 covered.

10 We understand that this issue is now coming to a  
11 head with respect to Axis because that the coverage or the  
12 amount under the primary policy and the amount under the first  
13 excess policy are almost used up, at least that's our  
14 understanding. So I know this states the obvious, but the only  
15 reason we're here, Your Honor, is because Axis wants you to tell  
16 them that they don't have to advance defense costs. And the  
17 rest of us, even though we've chosen different ways to oppose  
18 that, are here because we want to make sure that they do pay.  
19 Now, we recognize that Axis had two valid choices here. The  
20 first is to advance defense costs with a reservation of rights,  
21 which is what we think is what the policy envisions, and the  
22 second is seek a declaratory judgment that the costs are not  
23 covered by the policy.

24 Now, U.S. Specialty, the insurer under the primary  
25 policy, and Lexington, the insurer on the first excess chose --

1 ultimately chose option one, and they just they reserved their  
2 rights, and Axis has chosen option two.

3           We recognize that seeking a declaratory judgment  
4 of coverage can be perfectly appropriate. And, for example, if  
5 there were no underlying litigation claims or if the litigation  
6 claims were -- did not overlap, we're not disputing the  
7 procedure. What we are disputing is when there's a substantial  
8 overlap of the underlying facts, we believe the law is clear.  
9 A declaratory judgment may not precede and has to defer to the  
10 underlying litigation for a determination of those facts. And  
11 we believe this is pretty much the universal rule. We don't  
12 think the rule is different in Illinois than in New York. I  
13 think the rule is exactly the same.

14           And, Your Honor, there are at least two key  
15 reasons for that rule. The first is that there is a  
16 significant risk that a determination -- an early determination  
17 in the coverage action -- would be prejudicial in the  
18 underlying actions either through collateral estoppel, the law  
19 of the case, or even -- or for other issues.

20           The second reason is since if you're litigating the  
21 same issues at the very least you're duplicating effort. You're  
22 running up even more defense costs, more expenses on the very  
23 same things, and that seems to be counter to good sense and  
24 issues of judicial economy.

25           So we filed our motion to dismiss and we believe

1 that what we're saying in the motion to dismiss is that because  
2 the courts are clear, the courts are clear that when there is a  
3 substantial overlap the coverage action must defer, that under  
4 Rule 12(b)(6) Axis is not in a position to be able to prove  
5 their case and therefore dismissal without prejudice is  
6 appropriate.

7 Now, let me get to the core of the issue, which is  
8 substantial overlap. Here in Refco, on the one hand, we've got  
9 the criminal and fraud actions. And the factual issues  
10 underpinning those actions all relate to whether Bennett and  
11 others manipulated Refco's books and records. All of the  
12 alleged actions that relate to the manipulation appear in the  
13 indictment and in the various securities complaints, and  
14 interestingly enough, they're all explicitly referred to in  
15 Axis's complaint.

16 On the other hand, we have the coverage action.  
17 Now, Axis's characterization is that the factual issue is  
18 whether Bennett failed to disclose potential claims based on  
19 his alleged manipulation of the books and records. But saying  
20 it that way doesn't change the fact that the facts are really  
21 the same. Without the alleged manipulation, there's nothing  
22 really to disclose.

23 Axis points to Illinois law, in particular the  
24 Guidant [Ph.] case as determinative. First of all, we strongly  
25 disagree that Illinois law applies, and I can come back to

1 this, Your Honor, but the absence of a choice of law in the  
2 contract means that under New York's choice of law rules look at  
3 various factors, the most important of which is the location of  
4 the insured risk. And, given that Refco's principal place of  
5 business was in New York, that's where the executive officers  
6 did their business and all the allegations related to coverage  
7 issues were about actions taken by certain executive officers,  
8 it's hard to argue that New York was not the location of the  
9 insured risk. But even if New York law applied, we think that  
10 the answer on substantial overlap would be the same and we're  
11 going to focus on Guidant.

12 Now, before I do, though, I do want to make a  
13 point that there are Illinois decisions on the issue of whether  
14 advancement is appropriate during the pendency of a coverage  
15 action where New York law and Illinois law appear to differ  
16 markedly, and that is why we believe New York law is the law  
17 that should apply here. But for the substantial overlap, we  
18 think the test is pretty much the same.

19 So in Guidant, what was going on? In the  
20 underlying actions, you have essentially a bunch of personal  
21 injury claims that were couched in language of fraud. And I'm  
22 assuming that they were done that way because today's medical  
23 dominated society if you're going to have something implanted in  
24 your body, undoubtedly you're going to be signing a waiver, an  
25 assumption of the risk. And the only way around that is to

1 demonstrate that you are not told all of the appropriate facts.

2 So the underlying factual issue is the misrepresentation about  
3 the safety of the medical device and the risk of the medical  
4 device.

5 In the coverage action, however --

6 THE COURT: Well, can I -- I'm sorry. Go ahead.  
7 Go ahead.

8 MR. WALSH: in the coverage action, however, it's  
9 not that the device was actually defective or unsafe, but that  
10 complaints had been received by the company, that the company  
11 knew about and didn't disclose, so that's why the Guidant case  
12 made a distinction and we can -- they were saying that we can  
13 make a determination. The trial court can make a determination  
14 that as a factual matter, yes, they received complaints or,  
15 yes, they didn't receive complaints, and it's not really  
16 dependent upon whether the device was defective or not.

17 So the distinction with our case is in Refco you  
18 can't make that distinction. Without one, you can't have the  
19 other. At the end of the day, Axis can't get up and explain to  
20 you what was it that Bennett should have disclosed if in fact  
21 he did not manipulate the books or he did not commit fraud.  
22 What was there to disclose?

23 So as you noted earlier, Your Honor, although not  
24 involving Axis, this is not the first time this issue came up.

25 Justice Freedman addressed this very issue in connection with



1 Arch's request for a determination on coverage.

2           The way I view it, Your Honor, this is a classic  
3 problem of putting the cart before the horse. You've got all  
4 these -- this huge multi-district securities action that's all  
5 coming together and you've got the criminal complaints, and then  
6 you've got this coverage action. And what I foresee is if this  
7 coverage action really went forward on the issues and was going  
8 to determine the issues of what Bennett did, what he thought,  
9 et cetera, every plaintiff in the securities actions would have  
10 to come into this court, and all the discovery about all the  
11 facts would be taking place in this court. And it just seems  
12 completely backwards in my mind that the coverage dispute  
13 becomes the litigation for all these issues rather than the  
14 underlying actions. I just don't think that can be right.

15           From a policy perspective, I have to ask myself  
16 what, you know, what's the purpose of the D&O policy, and it's  
17 to protect officers and directors against claims for  
18 misconduct. And in my view, it would completely defeat that  
19 policy if the end result was that the insurer could do an end  
20 run and avoid the defense costs and get a ruling that could be  
21 used against the insured in the underlying actions. That's not  
22 what people will open all this insurance for. That doesn't  
23 provide any protection at all, so the answer here is, you know,  
24 clearly Axis has an issue here. They have to -- in our view,  
25 they have to advance defense costs but they have the right to

1 get those costs back once there is a decision on coverage if,  
2 in fact, it does go against the insureds.

3 On the part of the defendants, though, if they  
4 don't get defense costs, they -- any insurance may very well be  
5 a lower. We think the courts have assessed those competing  
6 risks and come down on this issue in favor of the insured.

7 So in this situation, we believe it's perfectly  
8 appropriate that the insurer has to wait for the results of the  
9 underlying action, and that's what you have today, and that's  
10 our reason, Your Honor, for asking the Court to dismiss the  
11 case.

12 THE COURT: Okay. So you take the view that I  
13 don't need to look at the policy language itself and interpret  
14 on the merits whether -- on a 12(b)(6) basis -- whether Axis is  
15 right or not. You just say it's premature?

16 MR. WALSH: Your Honor, it is our expectation that  
17 if this action was dismissed and especially if it was dismissed  
18 with the determination that New York law applies that Axis  
19 would go ahead and advance. You know, they're a highly, highly  
20 reputable company. If, however, they stand up today and say  
21 you know, no way we're advancing, then we'll have to go the next  
22 step, but what we're asking for today is a dismissal.

23 THE COURT: Okay. Thank you.

24 MS. GILBRIDE: Good morning, Your Honor. Joan  
25 Gilbride for Axis Reinsurance Company, Kaufman, Borgeest &

1 Ryan.

2 I'm a little confused after hearing oral argument  
3 from the director defendants on their motion for dismissal.  
4 Essentially, what they've sought from this court is a complete  
5 dismissal of this action, but at the same time they appear to  
6 be suggesting that they should get some sort of affirmative  
7 relief in the form of advancement of defense costs.

8 THE COURT: Not Mr. Walsh's clients.

9 MS. GILBRIDE: It's just -- it's -- what they're  
10 essentially seeking, though, Your Honor, is an inconsistent  
11 result.

12 THE COURT: But his clients haven't sought that.  
13 They haven't sought any sort of affirmative relief. They just  
14 sought dismissal.

15 MS. GILBRIDE: I just think it's important to note  
16 that Axis's position has been, Axis's position for over a year,  
17 is that there is no coverage for this matter under its policy.  
18 They took this position over a year ago. Axis is not going to  
19 change that position if this action gets dismissed. In fact,  
20 what the director defendants have said in their papers and I  
21 think have suggested to Your Honor is if this action is  
22 dismissed, they would have no alternative but to turn around  
23 and seek relief under the policy in another forum. And I think  
24 that just demonstrates the inconsistency, which a dismissal of  
25 this action would result in, particularly in light of the fact

1 that there are other defendants, other insureds who are seeking  
2 affirmative relief from Your Honor. In any event --

3 THE COURT: But why would that be the case if the  
4 other forum were, for example, the court handling the  
5 underlying litigation? Then all the discovery could be the  
6 same, all the trials could be the same. There wouldn't be two  
7 courts with potentially conflicting rulings or conflicting  
8 schedules, and particularly for the criminal defendants, risks  
9 about the Fifth Amendment.

10 MS. GILBRIDE: Well, Your Honor, that leads into  
11 really what is the heart of this dismissal motion, which is  
12 whether or not there are overlapping facts. We believe the  
13 issue is not whether there's substantial overlap of the facts,  
14 but whether the ultimate issues in the two dispute are the same  
15 and I think that that's clearly the test under Illinois law,  
16 which we submit applies to this dispute.

17 And the ultimate issues in the two cases are  
18 ultimate facts, the ultimate issues that the Court must  
19 determine are entirely different. The facts in the coverage  
20 dispute concern -- we have a warranty letter that we received  
21 from the insured. The question is was the warranty letter  
22 signed. It was signed on behalf of all insureds. Was there  
23 knowledge by Mr. Bennett or any other insured at the time that  
24 warranty letter was signed which might have led anyone to  
25 assume that there could potentially be a claim.

1           Those issues are very different than the issues  
2 that are in dispute in the securities fraud action, Your Honor.

3       You know, Axis does not have to establish that there was a  
4 fraud here. They simply have to establish that there was  
5 knowledge that there was this warranty letter that was signed.

6       There's a knowledge exclusion in the policy, which we  
7 understand there's issues about that. Those issues are not in  
8 dispute in the underlying securities litigation.

9           THE COURT: I'm sorry. Knowledge of what?

10          MS. GILBRIDE: Knowledge of whether or not there  
11 were facts at the time that the policies that was entered into  
12 that could potentially lead to a claim. That doesn't --

13          THE COURT: And isn't the -- all of the litigation  
14 brought against the Ds and Os a "claim" or potentially a  
15 "claim"?

16          MS. GILBRIDE: It is, Your Honor. But it's not the  
17 only claim that either Mr. Bennett or any other insured could  
18 have had knowledge of at the time they signed that warranty  
19 letter.

20          THE COURT: But it's the only claim that they're  
21 claiming on the policy on.

22          MS. GILBRIDE: Well, I think it's -- you know, it's  
23 a big picture "claim," but there were other issues and it's  
24 important to note that the warranty and the prior knowledge  
25 exclusion don't require knowledge of a claim. They require

1 knowledge of a fact, a circumstances, a situation. It's  
2 extremely broad, Your Honor.

3 So, for example, if there was an auditor's letter  
4 that was written in 2003 that Mr. Bennett was aware of and he  
5 was aware that there were issues raised in that auditor's letter  
6 that could potentially result in a claim and which ultimately  
7 did result in partially at least in some of the claims.

8 THE COURT: But aren't I right in assuming that by  
9 now any litigant or more practically speaking any plaintiff's  
10 lawyer would have jumped in and brought the claims against  
11 these directors and officers and that therefore it's in the  
12 litigation that's pending?

13 MS. GILBRIDE: I think that that's a correct  
14 assumption, Your Honor.

15 THE COURT: So aren't I also correct that in that  
16 litigation that's pending won't those people also want to obtain  
17 discovery of auditor's letters that he might've been aware of or  
18 that any of the other directors might have been aware of or any  
19 of the other facts that would relate to a claim, because that's  
20 what they're trying to establish, a claim. Isn't it a complete  
21 overlap of the policy?

22 MS. GILBRIDE: Your Honor, I think there's no  
23 question that there are overlapping facts in dispute. There's  
24 no question. But the ultimate facts and the ultimate issues  
25 that need to be decided in the coverage dispute are much

1 narrower and more focused than the very broad issues that are  
2 in dispute in the underlying securities fraud litigation. And  
3 in fact, the coverage --

4 THE COURT: I thought you were making the argument  
5 the other way around. I thought you were saying that, in fact,  
6 the securities litigation is more focused because we could  
7 be -- anything that might have gone through Bennett's mind could  
8 exclude Axis from having to pay. I mean, that's a pretty -- I  
9 mean, I guess that's something that you can assert given the way  
10 that provision is phrased -- "might give rise to a claim" --  
11 although it kind of makes you wonder whether the insurance is  
12 completely illusory. But you're saying that the -- maybe I  
13 misunderstood you then. You're saying that the actual  
14 litigation, the criminal litigation and then the securities  
15 action and the like would be more narrowly focused or wider  
16 focused?

17 MS. GILBRIDE: I think, you know, narrow or wider  
18 in different areas I think, Your Honor, but the important issue  
19 is that the ultimate facts to be determined in the two actions  
20 are different, and I think that's the test. No one in the  
21 securities litigation is going to care one way or the other  
22 factually whether or not Mr. Bennett signed a warranty for an  
23 insurance application. That's simply not going to be an issue.

24 THE COURT: Well, if you're talking that there's a  
25 factual dispute as to whether the thing was actually executed?

1 MS. GILBRIDE: I don't really think that's in  
2 dispute, but that is, in fact, what we have to establish in  
3 order to prevail in our coverage.

4 THE COURT: But don't you think that the district  
5 judge presiding over that litigation could decide that pretty  
6 quickly?

7 MS. GILBRIDE: Your Honor, I don't think that's an  
8 issue that's before the district judge. It's not an issue --

9 THE COURT: No, but if, in fact, I determine that  
10 this litigation before me is premature, particularly in light  
11 of my very tenuous jurisdiction given that Refco's plan is  
12 confirmed and effective and the provisions of the confirmation  
13 order, which clearly contemplate that this type of litigation  
14 could be elsewhere, why shouldn't the -- why shouldn't the easy  
15 lifting issue not control this thing and the hard lifting issue  
16 should, i.e., all the discovery as to whether there really was  
17 something related to a fraud, which is already before the  
18 district courts which probably have those issues? What --  
19 they're going to be doing the heavy lifting. Why have two  
20 courts do the heavy lifting, which requires all the parties to  
21 duplicate the heavy lifting in two different forums because of  
22 what appears to be perhaps even a hypothetical issue as to  
23 whether Bennett signed the memorandum, which is easy lifting?  
24 Why not have the district judge do that, too?

25 MS. GILBRIDE: Your Honor, I -- you know, another



1 procedural conundrum that we're faced with here is that  
2 dismissal is not sought by all of the insureds, so -- and there  
3 are --

4 THE COURT: No, but I can --

5 MS. GILBRIDE: -- counterclaims --

6 THE COURT: In controlling my docket, I can  
7 certainly do that, particularly when I have real doubts about  
8 jurisdiction. That's what Judge Gonzalez did in WorldCom.

9 MS. GILBRIDE: Your Honor, I -- you know,  
10 obviously that is within your discretion and your control. Our  
11 position simply is that this is a dispute that does not involve  
12 all of the over-arching issues that are involved in the  
13 securities litigation.

14 THE COURT: But other than whether Mr. Bennett  
15 signed the memorandum or the warranty, what other issues are  
16 different?

17 MS. GILBRIDE: Just the very fact of the  
18 insurance, Your Honor, it's not an issue in the underlying  
19 securities litigation.

20 THE COURT: What do you mean by that?

21 MS. GILBRIDE: Whether or not there's coverage,  
22 whether or not their defense costs are covered.

23 The issue -- the other motion that we're here on  
24 today, the advancement of defense costs, whether or not those  
25 defense costs will be covered, that's not an issue that is in

1 dispute or before --

2 THE COURT: It could certainly --

3 MS. GILBRIDE: -- Judge Lynch.

4 THE COURT: It can certainly come before Judge  
5 Lynch, though, couldn't it? I mean, it came before Judge Cote  
6 after Judge Gonzalez said he didn't have jurisdiction in  
7 WorldCom.

8 And as a practical matter, as we all know,  
9 litigations are also a forum for settlement, and as we all know  
10 insurance in these settings is a major aspect, sometimes the  
11 only aspect, but always a major aspect of the currency for  
12 settlement. So I would think whether it's Judge Lynch or a  
13 special master he's going to appoint or a mediator, that's --  
14 you know, it's going to be front and center there as a practical  
15 matter.

16 And I'm sure that if there's a mediation or  
17 settlement discussion in the securities litigation -- obviously  
18 this doesn't apply to criminal litigation, but in the securities  
19 litigation -- that one of the issues that the insurers will  
20 raise, even if it's not teed up formally in front of Judge  
21 Lynch, but in the negotiations is, well, "we don't have to pay  
22 for this. It's not covered, so, plaintiffs' lawyers, you should  
23 look somewhere else. Lower your demand, because you're settling  
24 two things." You're not only settling the fraud case, you're  
25 settling whether this exclusion applies.

1 MS. GILBRIDE: Well, Your Honor, one of the  
2 practical issues that Axis faced in deciding which forum to  
3 bring this litigation in is that there is no diversity  
4 jurisdiction, so we could not be before Judge Lynch or any  
5 other district judge, so there was no way for us as a practical  
6 matter to get before Judge Lynch. That was a consideration,  
7 but we felt it was appropriate to bring the action in this  
8 court, Your Honor, because of the fact that obviously that  
9 we're -- you know, the bankrupt -- the debtor is here before  
10 Your Honor and, you know, based upon prior rulings of Your  
11 Honor with respect to the insurance policy, we believe that  
12 this was an appropriate forum to be in.

13 THE COURT: Well, I haven't made any rulings as --  
14 you mean, the lift stay issue?

15 MS. GILBRIDE: Yes, Your Honor.

16 THE COURT: Okay. But the plan confirmation order  
17 says that "Notwithstanding anything in the plan or confirmation  
18 order to the contrary, nothing in the plan or confirmation  
19 order including, but not limited to the injunction provisions  
20 shall be construed to prevent present or former directors and  
21 officers of the Debtors from seeking and obtaining coverage and  
22 payments from insurance policies of Refco, Inc. or from  
23 insurance policies of any other Refco Entity by litigation  
24 against relevant insurance companies nor to prevent insurance  
25 companies, from making such payments."

1 MS. GILBRIDE: Your Honor, we don't read that as  
2 allowing us to affirmatively bring a declaratory judgment  
3 action. And perhaps it was an incorrect reading of that  
4 provision, but our understanding was that was limited to the  
5 individual directors --

6 THE COURT: Okay. But it's a --

7 MS. GILBRIDE: -- and officers.

8 THE COURT: -- big difference between seeking  
9 relief from the stay and starting, you know, a whole  
10 declaratory -- anyway, I'm not faulting you on that. Obviously,  
11 we're here. But I'm still having a hard time seeing why there  
12 isn't overlap.

13 MS. GILBRIDE: Your Honor, I could not stand in  
14 front of you and honestly say there is no overlap. There is  
15 absolutely overlap. It's just a question of whether the overlap  
16 is of some facts, and there are some, many facts that are -- do  
17 overlap, but there's not overlap of the ultimate facts and the  
18 ultimate issues that are going to be determined in each  
19 litigation.

20 This is a dispute that's about coverage. There are  
21 some issues that are similar that we've raised in terms of  
22 Mr. Bennett's knowledge and other insureds' knowledge, but the  
23 issue before Your Honor is an issue of policy interpretation,  
24 contract interpretation. The issue in the securities  
25 litigation is an issue of whether or not there was fraud on the

1 shareholders, and that's certainly not an issue that's in our  
2 case, whether or not there was a fraud.

3 THE COURT: But --

4 MS. GILBRIDE: So we don't believe that the  
5 ultimate issue is --

6 THE COURT: But isn't Mr. Walsh's argument right  
7 that the prior knowledge of a claim that's the ultimate basis  
8 for the disclaimer of coverage here and of defense costs, the  
9 obligation to advance defense costs, isn't that different than  
10 the types of fraud at issue in the Guidant [Ph.] case?

11 MS. GILBRIDE: Your Honor, you know, I think that  
12 the Guidant case is very on point with the issues that are at  
13 issue here. In Guidant, the question was whether or not there  
14 was a nondisclosure of an underlying situation to the insurer.  
15 It's the very same issue --

16 THE COURT: No, but of what?

17 MS. GILBRIDE: Of whether or not there was  
18 litigation or prior claims, so it's almost -- it's very on  
19 point, Your Honor.

20 THE COURT: But your provision doesn't say that.  
21 You're not looking to deny coverage here because Bennett didn't  
22 disclose to you that there was an investigation in place and  
23 that there was a claim that had been asserted. It's that the  
24 condition that might give rise to something like that was not  
25 revealed to your client.

1 MS. GILBRIDE: That's correct, Your Honor, but I  
2 think that --

3 THE COURT: And so --

4 MS. GILBRIDE: -- the issu --

5 THE COURT: -- if the fraud actions that were  
6 pending in Guidant were not about what was already known to --  
7 what specific claims that had been filed were already known to  
8 the insured -- they were about whether the insured failed to  
9 disclose information to the investing public about what it had  
10 been doing with its medical business, if that litigation had  
11 been about the failure to disclose -- if the 10K in that  
12 litigation had failed to disclose specific litigation claims or  
13 medical claims against it, there would have been an overlap,  
14 right?

15 MS. GILBRIDE: Well --

16 THE COURT: But that's not what it was about.

17 MS. GILBRIDE: Well, respectfully, Your Honor, I  
18 think that issue in Guidant was whether or not -- was about  
19 whether or not certain claims were disclosed to the insurer.  
20 The situation that we have here --

21 THE COURT: Not the securities litigation.

22 MS. GILBRIDE: Not the securities litigation.

23 THE COURT: Right.

24 MS. GILBRIDE: But the claims involving the  
25 products. But I -- you know, respectfully I just, I think that

1 it's -- the question is whether or not there was nondisclosure  
2 and whether it was about the securities litigation or not  
3 securities litigation. It was about facts that were known at  
4 the time. Here --

5 THE COURT: No, but it's important to know what --  
6 to distinguish what the particular facts are. I mean, the  
7 policy if -- if you're the -- if you're the court presiding over  
8 the insurance dispute, you have to ask yourself, well, what  
9 will I learn from the securities law action that will either be  
10 dispositive or provide real guidance as to my dispute. And in  
11 the Guidant case if you're the judge presiding over that  
12 insurance dispute, I'm not sure that those facts are relevant  
13 because it's a different type of fraud. There are two different  
14 types of fraud that are being litigated. The fact -- the  
15 underlying nondisclosure is different.

16 MS. GILBRIDE: I think that's -- it's correct that  
17 the underlying nondisclosure was different. There's no  
18 question, but I think it was the fact of the nondisclosure that  
19 was the issue and it was the same issue in both cases but the  
20 ultimate issue in both cases was different, so I believe that  
21 the Guidant -- how the Guidant court determined that issue is  
22 very instructive in this situation for Your Honor.

23 THE COURT: But isn't this doctrine of prematurity  
24 or ripeness, isn't it really ultimately a doctrine based upon  
25 considerations of fairness and efficiency as opposed to, you

1 know, distinctions or technical distinctions between the  
2 ultimate issue in each matter? I mean, obviously the ultimate  
3 issue is going to be different in each matter because it's a  
4 given that the people suing for securities fraud are not  
5 specifically suing to enforce the terms of an insurance policy,  
6 so it's -- you know, there's always going to be a difference on  
7 the ultimate issue in some respects.

8 MS. GILBRIDE: Your Honor, I do believe that it is  
9 an issue of fairness and judicial economy and I believe -- you  
10 know, we have a ripe dispute. There's no question, but there's  
11 a ripe dispute right now between Axis and its insureds. Axis  
12 is getting requests for advancement and requests to -- all  
13 sorts of requests for depletion of its policy limits. So  
14 there's no question but that we have a ripe dispute and that we  
15 believe that this is the appropriate forum to be in to resolve  
16 that dispute.

17 We do not believe -- you know, all of the issues  
18 that are in dispute in the securities litigation are not in  
19 dispute in this case. This is -- and I apologize if there was  
20 any misimpression given, but I believe this is a much more  
21 narrow --

22 THE COURT: But isn't there always a dispute? I  
23 mean, it's not really a ripeness issue, is it? If it were a  
24 ripeness issue, then this doctrine of overlap wouldn't apply,  
25 because the courts don't say that the securities -- that the



1 court handling the securities law case has to decide the  
2 insurance dispute. It just says that we're not going to -- we,  
3 the insurance court, are not going to decide it. Now, am I  
4 right on that?

5 MS. GILBRIDE: I think you are right on that, Your  
6 Honor. I think -- and what I was trying to articulate not very  
7 clearly apparently was that you were asking whether this was  
8 about judicial economy and fairness to the parties and I think  
9 that that is what this is about and that is what drives that  
10 doctrine, and this -- no one can suggest that this dispute is  
11 premature. This is not a premature dispute. There is  
12 certainly a dispute. There is a dispute that can be litigated.

13 We believe it will be a much more narrow litigation than the  
14 securities litigation that's in the District Court before Judge  
15 Lynch. And we believe that it serves the interests of judicial  
16 economy and fairness to all parties. And, you know, in  
17 particular Axis who's being asked to make payments as policy  
18 limits without being allowed to get a ruling from a court that  
19 there's no coverage under the policy.

20 THE COURT: But isn't -- doesn't in effect what  
21 these overlap cases hold is that the insurer, you know, has to  
22 take a back seat on that? I mean, isn't that a consequence of  
23 these decisions?

24 MS. GILBRIDE: I think that is. When -- and I  
25 think when that happens the reason it happens is because the

1 issues that are in the coverage litigation are going to be  
2 decided in the underlying litigation. So, for example, if  
3 there's an underlying dispute that involves issues of negligence  
4 and issues of intentional conduct and the insurer is saying,  
5 well, we don't cover intentional conduct, in those situations  
6 courts -- and that's the vast majority of the cases that deal  
7 with this issue -- the courts say, well, it's a waste of our  
8 time to decide whether there was negligence or intentional  
9 conduct, because that will be decided in the underlying case.

10 THE COURT: Right.

11 MS. GILBRIDE: Here, that's not the situation. The  
12 coverage issue that we have, whether or not the prior knowledge  
13 exclusion applies and whether or not the warranty letter  
14 applies, are not going to be decided in the securities  
15 litigation.

16 So for those reasons, Your Honor, I don't  
17 believe --

18 THE COURT: I thought you were going somewhere  
19 else.

20 MS. GILBRIDE: -- the dismissal --

21 THE COURT: I guess I thought you were going  
22 somewhere else with that, which is that were going to have to  
23 take our chances on advancing or not advancing defense costs  
24 pending a decision, and that -- and I thought you were going to  
25 say -- that's not fair and the cases don't deal with that issue,

1 but don't they?

2 MS. GILBRIDE: Your Honor, I don't believe they do  
3 because as far as I know, there's not one case cited before Your  
4 Honor which has the precise language that is at issue in this  
5 dispute where Axis is only required to advance covered defense  
6 costs.

7 THE COURT: But that --

8 MS. GILBRIDE: Not --

9 THE COURT: I'm sorry, go ahead.

10 MS. GILBRIDE: No, I was just going to -- none of  
11 the cases that have been put before Your Honor deal with that  
12 precise issue and that certainly has not been an issue in any  
13 dismissal rulings that have been put before Your Honor.

14 THE COURT: But isn't it the case that the insurers  
15 are declining -- in the cases where there's a dismissal without  
16 prejudice based on this doctrine of substantial overlap, isn't  
17 it the case that the insurers have denied coverage or sought to  
18 rescind, which would include rescission of their obligation to  
19 pay defense costs?

20 MS. GILBRIDE: I think in the vast majority of the  
21 cases that have so held, Your Honor, the situation was that you  
22 have an insurer, a duty-to-defend insurer who was required to  
23 advance defense costs, and was taking a position that because  
24 there was negligence and intentional conduct they didn't have to  
25 defend -- they didn't have to pay defense or provide a defense

1 for any of those claims.

2 THE COURT: Right.

3 MS. GILBRIDE: So in that situation where the  
4 Court said the coverage dispute is premature, the insurer did  
5 have a duty to defend the entire action, but our situation --

6 THE COURT: So it was ripe because they had to pay  
7 the money even though they said they didn't have to.

8 MS. GILBRIDE: It was ripe, but based on the  
9 policy language that was in dispute in those cases, I think  
10 here the distinguishing fact is that Axis's policy only requires  
11 it to advance "covered" defense costs.

12 THE COURT: But doesn't everyone have a  
13 distinguishing fact, that's why they brought their lawsuit to  
14 rescind, you know. I mean --

15 [Laughter.]

16 THE COURT: I understand your --

17 MS. GILBRIDE: Yeah.

18 THE COURT: -- point --

19 MS. GILBRIDE: Your Honor --

20 THE COURT: -- of a specific provision, but --

21 MS. GILBRIDE: Yeah. I'm not sure how to answer  
22 that. I think that was in jest, but obviously there's always  
23 different disputed facts.

24 I don't think I have anything more to add on this  
25 issue unless Your Honor has any further questions for me.

1 THE COURT: Okay.

2 MS. GILBRIDE: But, you know, in summation I would  
3 say that, you know, we don't believe dismissal is the  
4 appropriate remedy. If Your Honor is concerned about the  
5 overlaps and facts, there are other remedies that could be  
6 considered, particularly a stay or stay as part of the action  
7 is that was what Your Honor is --

8 THE COURT: Well, the directors and officers  
9 represented by Mr. Walsh are looking for dismissal without  
10 prejudice. They recognize that this issue is going to come up  
11 if it's not settled somewhere. So I mean, isn't that tantamount  
12 to a stay?

13 MS. GILBRIDE: Your Honor, I think they do --

14 THE COURT: And --

15 MS. GILBRIDE: -- in the alternative ask for a  
16 stay.

17 THE COURT: Well, someone -- I don't think so. I  
18 think that's the criminal defendants --

19 MS. GILBRIDE: Okay. Okay.

20 THE COURT: -- that are asking for a stay.

21 MS. GILBRIDE: That's my confusion, then.

22 THE COURT: I under -- this is kind of off the --  
23 you can stay up there if you want.

24 MS. GILBRIDE: Sure.

25 THE COURT: But it's addressed to everybody and

1 really it's off the point, but I -- does anyone know how the  
2 insurance litigation got before Judge Cote? I would assume  
3 that there would have been lack of diversity there as well.  
4 Maybe no one argued -- maybe no one raised the issue.

5 MALE SPEAKER: Your Honor, I believe there's a  
6 motion of jurisdiction --

7 THE COURT: There was.

8 MALE SPEAKER: -- actions were filed by the  
9 carriers in the same courthouse and --

10 THE COURT: Okay.

11 MALE SPEAKER: -- it was before Judge Cote.

12 THE COURT: All right.

13 MALE SPEAKER: Little different situation.

14 THE COURT: All right.

15 MR. FERRILLO: Your Honor, Paul Ferrillo from  
16 Weil, Gotshal. I was with Mr. Borgeest in that case, too.  
17 There's another piece to that was I think Judge Cote took part  
18 of this on the related jurisdiction and that the --

19 THE COURT: Under bankruptcy.

20 MR. FERRILLO: It was -- yes, on -- for the 1334.  
21 She took a piece of it on the 1334.

22 THE COURT: Well, that's conceivable here, I would  
23 think. I mean, I -- as I said, I've got -- I raised this  
24 jurisdictional issue at the pretrial conference and I was  
25 convinced enough then, since the policy is property of the

1 estate, and there's some possibility that it will flow over in  
2 some way to the estate, that there could be jurisdiction here,  
3 but as you all know my jurisdiction becomes constricted after a  
4 plan goes effective. And while it may still exist, it may  
5 much -- it may more -- much more readily be employed by the  
6 District Court that in an action that for a lot of reasons it  
7 would be efficient for the District Court to employ it that  
8 way, so I wouldn't necessarily rule out that you couldn't raise  
9 it in that forum, but that's neither here nor there, I guess.

10 MS. GILBRIDE: Thank you, Your Honor.

11 THE COURT: Okay.

12 MR. WALSH: Except a couple points, Your Honor.  
13 First of all, I don't have any problem with your jurisdiction in  
14 this case, but I understand the posture of the case is in --

15 THE COURT: Well, let me be clear. I've not  
16 determined that I lack jurisdiction. It's just that I need to  
17 be careful about it and not over-extend it and let other issues  
18 sort of creep in through the limited jurisdiction that I have.

19 MR. WALSH: I appreciate that, Your Honor.

20 I just wanted to respond to a couple of things  
21 that were said. And perhaps I heard this wrong, but I thought  
22 what was said was that what -- in Guidant the standard was not  
23 a substantial overlap and I think that's incorrect. Guidant  
24 says "As a general matter a declaratory judgment action to  
25 determine an insurer's duty to indemnify its insured should not

1 be decided prior to the adjudication of the underlying action  
2 where the issues to be decided in both actions are  
3 substantially similar." So that's the standard under Guidant.

4 And we have essentially the same effect in New  
5 York in the Xerox case where the Court said that "The general  
6 rule is that a declaratory judgment as to a carrier's obligation  
7 to indemnify may be granted in advance of trial of the  
8 underlying tort action only if it can be concluded as a matter  
9 of law that there is no possible factual or legal basis on  
10 which the insurer may eventually be held liable under this  
11 policy." So I think that that sets the standard. It doesn't  
12 have to be, you know, precisely the same.

13 And, in fact, if there wasn't a substantial  
14 overlap, I have to ask the question why is it that Axis spent  
15 five pages and 20 paragraphs reciting the allegations in the  
16 indictment and the Grant memo? I think the only answer is  
17 because those facts are key to the issue of -- that there had  
18 to be disclosure of claims.

19 The only other thing I want to point out is the  
20 contract, and maybe this goes to the issue of fairness, but the  
21 contract requires advancement unless there's a "final  
22 determination," and I think that's the quandry that Axis finds  
23 itself in and that's what they should do. They should live up  
24 to their contract. Thank you, Your Honor.

25 MS. GILBRIDE: Your Honor, just briefly because I



1 can't let it go unchallenged, but the policy does not require  
2 advancement. It requires advancement of "covered" defense  
3 costs, but --

4 THE COURT: I know. Mr. Walsh sort of cut back  
5 his statement that he wasn't seeking a determination as to the  
6 policy.

7 MS. GILBRIDE: And it's a very key word in the  
8 policy and it's, you know --

9 THE COURT: I understand there's a heated dispute  
10 over that issue.

11 [Pause in the proceedings.]

12 THE COURT: Does anyone else want to be heard on  
13 this particular motion; that is, the motion to dismiss?

14 MR. GOLDMAN: Your Honor, Matthew Goldman. I'm  
15 assuming that the Court will proceed after this two-hour  
16 motion. It's --

17 THE COURT: Yes.

18 MR. GOLDMAN: -- our view obviously that -- I've  
19 listened to a lot of what I was going to say already being  
20 discussed with the Court, so --

21 THE COURT: Okay.

22 MR. GOLDMAN: -- I presume I'll get an opportunity  
23 to be heard on that issue, Your Honor.

24 THE COURT: Okay.

25 MR. GOLDMAN: Thank you, Your Honor.

1                   THE COURT: Absolutely. Also, the motion for  
2 relief from the stay.

3                   [Pause in the proceedings.]

4                   THE COURT: All right. I have before me a motion  
5 by certain defendants in this adversary proceeding, namely  
6 Messrs. Brightman, Gantscher, Harkins, Jaekel, Lee, O'Kelly and  
7 Schoen, who define themselves as the "director defendants," to  
8 dismiss the adversary proceeding under Federal Rule 12(b)(6)  
9 incorporated by Bankruptcy Rule 7012. The standard for  
10 determining a motion to dismiss is well recognized; that is,  
11 the Court must accept all factual allegations in the complaint  
12 as true, although the plaintiff must plead more than labels and  
13 conclusions, and a formulaic recitation of the elements of the  
14 cause of action will not do. See Bell Atlantic Corporation v.  
15 Toombley, 127 Supreme Court 1965, 1995 (2007). But, with the  
16 caveat announced in the Bell Atlantic case or reaffirmed in the  
17 Bell Atlantic case, the Court should determine whether, based  
18 on the facts set forth in the complaint as well as other  
19 sources that the courts are permitted to examine under Rule  
20 12(b)(6) (including in particular documents incorporated in the  
21 complaint by reference and matters which the Court may take  
22 judicial notice of), the plaintiff should be entitled to  
23 ultimately submit evidence and establish the facts alleged or  
24 whether it should be precluded as a matter of law from going  
25 forward. Here these particular debtor defendants -- director

1 defendants -- are seeking dismissal without prejudice on a  
2 relatively narrow basis. That is, unlike certain of the other  
3 beneficiaries of the Axis Reinsurance policy, they're not asking  
4 the Court to determine that Axis is required to advance defense  
5 costs by the terms of the policy.

6           Instead, although they're obviously not agreeing  
7 with Axis's position that it's not required to advance those  
8 costs, these director defendants contend that because of the  
9 substantial overlap of the issues raised by Axis's declaratory  
10 judgment complaint with the issues pending in respect of the  
11 underlying claims which the beneficiaries contend trigger their  
12 rights under the policy in the District Court in pending  
13 securities litigation as well as in any other litigation, but  
14 primarily that litigation, that the Court should not proceed  
15 here with a determination of essentially those same issues, or  
16 at least issues that substantially overlap with the issues  
17 pending in the District Court.

18           This basis for dismissal without prejudice is well  
19 recognized in the case law. See National Union Fire Insurance  
20 Company v. Xerox Corporation, 792 N.Y.S. 2d. 772 (New York  
21 Supreme Court 2004), affirmed 807 NYS 2d. 344 (New York  
22 Appellate Division 2006) as well as In Re: Adelphia  
23 Communications Corporation, 302 B.R. 439 (Bankr. S.D.N.Y.  
24 2003).

25           It is not only, however, a principle in New York,

1 but also recognized, it appears to me, based on reading the  
2 parties' pleadings, generally throughout the country; and Axis,  
3 I believe, acknowledges the fundamental proposition that if  
4 there is a substantial overlap of the issues in coverage  
5 litigation with other pending litigation related to the claims  
6 to be covered that the coverage litigation should take the back  
7 seat.

8 Axis contends, however, that as a factual matter there is  
9 not an overlap that would require a dismissal here. It relies  
10 heavily upon a decision out of Illinois, Alliance Insurance  
11 Company v. Guidant Corp., 839 NE 2d. 113 (Ill. App. 2005) in  
12 making its argument.

13 I should note, however, that the Guidant case  
14 enunciates the general proposition that a declaratory judgment  
15 action to determine an insurer's duty to indemnify its insured  
16 should not be decided prior to the adjudication of the  
17 underlying action where the issues to be decided in both  
18 actions are substantially similar. That's at page 120.

19 So it appears to me, at least on the general  
20 proposition, that there's no real conflict between the law of  
21 New York and the law of Illinois here -- on this key  
22 proposition of law. And where there is no such conflict, the  
23 court need not continue with a choice of law analysis.

24 However, I will do so because there is some  
25 distinction, although I don't think a major one, between how the

1 Guidant Corp. case -- I'm sorry, the Guidant Corp. court  
2 analyzed the overlap issue from how other courts have done so  
3 in New York.

4           In that regard, although this is more relevant to  
5 Axis's interpretation of its rights in respect of the policy  
6 generally, which are not being litigated here by these  
7 particular director defendants, Axis contends that this dispute  
8 in this declaratory judgment action is governed by Illinois  
9 law, whereas the director defendants contend, to the contrary,  
10 that it should be governed by New York law.

11           I've not seen a provision in the policy itself  
12 setting forth the choice of law, and no one has cited that to  
13 me. Instead, they have properly set forth the choice of law  
14 rule in the absence of such a provision, which is that New York  
15 choice of law rules should apply here given that this action is  
16 being determined by a court in New York, and that the center of  
17 gravity analysis (which, as far as I'm concerned, is  
18 substantially the same as if not entirely the same as  
19 substantial contacts analysis) would apply as to disputes in  
20 respect of insurance coverage.

21           The parties also generally agree on the factors to  
22 be considered in connection with such an analysis. In looking  
23 at those factors here, and taking note particularly of Refco,  
24 Inc.'s headquarters and the place where its executives took the  
25 actions or allegedly took the actions at issue here, as well as

1 the residence of substantially all the defendants, the  
2 headquarters of the insurer, but primarily where the underlying  
3 activity occurred, it appears to me that New York law should  
4 apply.

5 And, therefore, to the extent that there is any  
6 substantive difference on the so-called "substantial overlap  
7 doctrine," I would follow the dictates of New York law and as  
8 it applied by the New York cases.

9 In considering those cases, it appears to me that  
10 the rationale for applying the doctrine fits these particular  
11 circumstances. That rationale is twofold. First and most  
12 important, it reflects a policy not to prejudice the parties'  
13 rights in the underlying pending action with the risk of -- in  
14 particular in criminal actions, but also in civil actions --  
15 having to make disclosures and litigate in two forums with  
16 potentially inconsistent results; and, as importantly in this  
17 context -- and particularly given the insurance context and the  
18 issue of advancing defense costs, greatly increased cost --  
19 that rationale dovetails into the second rationale, which is  
20 one based on judicial efficiency.

21 As discussed at oral argument, it appears to me  
22 that this is not -- this doctrine is not really one that should  
23 best be defined as "ripeness," per se, because there is  
24 obviously a ripe issue that is being deferred in the cases that  
25 apply the doctrine. That is, the insurer contends one way or

1 another that it is not responsible for paying under its policy,  
2 but the courts say nevertheless that that issue should not be  
3 decided first where there's substantial overlap with the  
4 underlying litigation. Rather, the insurer should either  
5 perform its obligations or at its own risk not perform them and  
6 contend later that it never had an obligation to perform them  
7 as the underlying litigation proceeds.

8 I note in this respect that as set forth at length  
9 by Judge Cote in In Re: WorldCom Inc. Securities Litigation,  
10 354 F. Supp. 2d. 455 (S.D.N.Y. 2005), there are strong policies  
11 under New York law with regard to interpreting insurance  
12 policies in favor of the insured -- particularly in construing  
13 the meaning of exclusions incorporated into a policy of  
14 insurance or provisions seeking to narrow the insurer's  
15 liability -- and, further, that the distinct and separate duty  
16 of an insurer to pay defense costs, that is, distinct and  
17 separate from a duty to indemnify, is broader than the duty to  
18 indemnify and not to be taken lightly as a policy matter. That  
19 may help to explain in addition to notions of fairness and  
20 efficiency why this doctrine goes beyond the doctrine of  
21 ripeness.

22 Now, turning to Axis's argument that there is not a  
23 substantial overlap between the litigation pending before me  
24 and the multi-district securities litigation and other  
25 litigation that it is asserted by the defendants here to give

1 rise to an obligation to advance defense costs (and if  
2 liability is ultimately found or there's a settlement, an  
3 obligation to pay indemnification), it appears clear to me that  
4 there is indeed a substantial overlap between that litigation  
5 and the declaratory judgment litigation before me.

6           Axis as set forth in its complaint is relying  
7 primarily, although not exclusively, upon a "warranty" letter,  
8 so called by Axis, received at the time that -- or "in  
9 connection with," in the words of the complaint, "the  
10 underwriting of the Axis policy." That warranty letter  
11 provides as follows: "(a) No person or entity proposed for  
12 this insurance is cognizant of any facts, circumstance,  
13 situation, act, error or omission which he, she, it has reason  
14 to suppose might afford grounds for any Claim [as such term is  
15 defined in the policy] such as would fall within the scope of  
16 the proposed insurance" and then one exception is listed to  
17 that.

18           And then "(b) No person or entity proposed for this  
19 insurance is cognizant of any inquiry investigation or  
20 communication which he, she, it has reason to suppose might  
21 give rise to a Claim [as such term is defined within the  
22 policy] such as would fall within the scope of the proposed  
23 insurance."

24           Other bases for the rejection of coverage are set  
25 forth in paragraphs 49 and 50 of the complaint, as well as



1 paragraphs 52 and 53, but it seems to me that, leaving aside  
2 issues of what's in the policy itself as opposed to what's  
3 extrinsic to it and may give rise to some other claim, the  
4 focus of the discussion regarding overlap has been over the  
5 language quoted, and more particularly over the language quoted  
6 in paragraph "(a)" of the so-called warranty.

7           It appears to me that if one considers the fact  
8 that the plaintiffs in the securities fraud litigation are  
9 suing the defendants in respect of "claims" or what would be  
10 "claims" if they prevailed, they will be seeking in discovery  
11 and seeking to prove, the defendants' "cognizance of  
12 circumstances, situations, acts, errors or omissions that would  
13 give rise to such a claim," i.e., their knowledge of, and/or  
14 participation in frauds and other bases for the claims in the  
15 securities action. That will be the subject of the discovery -  
16 - which, as is evident by the enormous costs that have already  
17 been incurred (and I note here that we're now here in the third  
18 layer or the second layer of excess coverage), is enormous --  
19 multi-million dollars -- the plaintiffs will be, if they've not  
20 already been, seeking to obtain from the defendants. Those are  
21 also the issues that I believe that if the litigation is  
22 decided on its merits will be determined by the District Court.

23  
24           As I said in oral argument, I believe those are  
25 also issues that would come up in any settlement discussions

1 with the insurer and the insurer's inevitable statement to the  
2 plaintiffs that even if the defendants are liable the  
3 plaintiffs shouldn't look to the insurers because they  
4 disclaimed coverage under this warranty and the other  
5 provisions set forth in the complaint.

6           So I believe that there is indeed a substantial  
7 overlap between the issues raised in the complaint and the  
8 pending litigation. That's highlighted by the fact that the  
9 complaint relies almost exclusively, if not exclusively, on  
10 recitations from either -- well, recitations from documents  
11 filed in the securities action or related criminal proceedings  
12 to establish the breach of the warranty and the insurer's rights  
13 under the other exclusions referred to in the complaint.

14           I believe these facts distinguish this matter from  
15 the matter before the Court in the Guidant case, where it  
16 appears clear to me that the court considering insurance  
17 coverage issues in the Guidant case had to consider different  
18 underlying factual issues as to the nature of the -- as to a  
19 different type of fraud that would have given rise to arguably  
20 a denial of coverage.

21           As I noted at oral argument, the issues that do  
22 not overlap here -- and inevitably there will be some because  
23 we're dealing with here an insurance policy as opposed to the  
24 facts that might give rise to a right under the policy or under  
25 related documents to disclaim coverage -- should not guide my

1 decision. Those differences do not call into question issues  
2 of efficiency or fairness. As I said before, the heavy lifting  
3 in this dispute is over the underlying factual point as to  
4 whether there was knowledge of conditions giving rise to a  
5 "claim." That's heavy lifting in the first instance by the  
6 parties in their discovery and in the second instance by the  
7 parties and the court in determining the merits of that  
8 contention, and that's already going to be taking place in the  
9 District Court. It seems to me that, therefore, this  
10 litigation should be deferred under the substantial overlap  
11 cases to await determination by the District Court of those  
12 underlying issues.

13           It also seems to me that there is a basis as  
14 discussed in oral argument, if the District Court agrees, for  
15 the District Court to have jurisdiction over these issues if  
16 they are to be teed up there, as was done in the WorldCom  
17 Securities case, which involved a similar situation where a  
18 plan had been confirmed and gone effective and the bankruptcy  
19 court had some concern about how involved it should be in  
20 issues that should be primarily between third parties to the  
21 bankruptcy case.

22           So on that basis, I will grant the director  
23 defendants' motion to dismiss, without prejudice, although I  
24 would strongly encourage the parties if they were ultimately to  
25 pursue this litigation to pursue it in a different forum

1 because of the jurisdictional concerns that I've raised.

2 Mr. Walsh, you can submit an order to that effect  
3 after circulating it to counsel for Axis.

4 MR. WALSH: I will do that, Your Honor.

5 THE COURT: And I suppose to your allies in the  
6 defendant group.

7 MR. WALSH: Thank you, Your Honor.

8 THE COURT: Okay.

9 MS. GILBRIDE: Your Honor, if I may just to  
10 clarify, you've now dismissed the entire litigation?

11 THE COURT: Well, that's my inclination. I'll hear  
12 oral argument, but that's my inclination. I'll hear oral  
13 argument on this motion, but it seems to me it all should go.

14 MS. GILBRIDE: Your Honor, it seems to me if  
15 another court, another forum is going to hear this issue, there  
16 really is no --

17 THE COURT: Well, you know what? As far as the  
18 other defendants are concerned, that's my preliminary ruling. I  
19 don't want to -- I said specifically to Mr. Goldman and his  
20 colleagues that I would hear them out on this other point, but  
21 that's my strong inclination.

22 In other words, he has an uphill fight.

23 MR. GOLDMAN: And I heard that, Your Honor. Okay.  
24 So I guess it's one of the disadvantages of going last. You  
25 get so many other things resolved for you and said. Let me

1 make this easier for all -- everyone.

2 First of all, there's no reason for me to discuss  
3 facts. I don't think there's a single fact that has been raised  
4 in here in our papers that has not been discussed by the Court  
5 so far this morning: the provisions in question, and the  
6 primary insurance policy, the follow-on provisions, and et  
7 cetera.

8 I would add that I felt and feel that the Court  
9 has raised the jurisdiction issue, of course, at the pretrial  
10 hearing as well as today. I will indicate for the benefit of  
11 the Court that we in fact -- the reason I stated on the record  
12 I believed this Court had subject matter jurisdiction under  
13 1334 was that the estate continues to have an interest in  
14 potentially obtaining proceeds of these policies; and in that  
15 situation I would add, although it's not before the Court  
16 immediately, that in the lift stay motion I reached agreement  
17 with Mr. Kirschner's counsel that I am to put on the record that  
18 we must provide him notice and give him an opportunity to be  
19 heard if he wishes to be heard regarding any compromise  
20 precisely because he recognizes that that interest is one of  
21 import to him and, of course, we have no difficulty with that.

22 The Court did recognize as I had neglected to in  
23 my moving papers, but did remember last night, that the plan  
24 confirmation order in fact dealt with the lift stay issues that  
25 were raised, but I don't think that that changes the Section

1 1334 issue and I don't think that the Section 1334 basis for  
2 jurisdiction --

3 THE COURT: No, I'm not --

4 MR. GOLDMAN: Yeah.

5 THE COURT: I agree with you. I'm not -- and my  
6 holding is not based on a finding that I lack jurisdiction,  
7 only -- it only reflects that it's another factor in the  
8 conclusion I reached that under the substantial overlap cases  
9 the underlying basis for that doctrine would apply here, which  
10 is that as bankruptcy cases end there's kind of a fade in the  
11 role of the bankruptcy court. And when the case law is already  
12 pointing you to go to the other court, that's another factor  
13 that just increases my inclination to send it to the other  
14 court.

15 MR. GOLDMAN: I understand, Your Honor. I would  
16 add -- I would recognize, as we all must, the brave new world  
17 of post-confirmation jurisdiction as it is, but I would add  
18 further and would stress for the Court -- Your Honor, you have  
19 acknowledged, I think, all of as I said the facts that I would  
20 have reported to you in respect of our preliminary injunction  
21 motion. The one which I think you've also acknowledged earlier  
22 in these arguments is that we are -- that Axis is, as they say,  
23 up to bat.

24 The harm which Judge Cote identified for us as  
25 defendants and actions particularly, of course, for the people

1 on whom -- on whose bases I speak who we have usually  
2 characterized as the so-called innocent defendants is that we  
3 will have disruption which Judge Cote identified as harm that  
4 it has to be addressed immediately. Lexington is out. We are  
5 facing immense obligations to proceed in these matters and we  
6 need to have a lack of disruption of our ability to have a  
7 defense mounted on behalf of the defendants.

8 I would add also the Court has identified that  
9 Axis is relying and primarily on an interpretation of the word  
10 "covered" in its policy language to argue that they can make  
11 that determination on their own and ignore the obligation to  
12 advance the costs -- defense costs "as incurred" with a  
13 concomitant right of access to seek recoupment later on after  
14 it is "finally determined" that -- presumptively by a court and  
15 not by Axis -- that the defense costs should not have been  
16 advanced.

17 And, of course, as the Court has already  
18 acknowledged, this is language which has been identified as  
19 important as a matter of case law and policy both by Judge Cote  
20 and in the Kozlowski [Ph.] case.

21 We face that concern now. We face the need for  
22 the Court and not Axis to determine their obligation to advance  
23 defense costs. It is not just because they say so. We face  
24 the need now for a determination that it is covered as we have  
25 identified in our moving papers, and, of course, the Court is

1 clearly familiar with them. The case law is consistent that it  
2 is simply a question of looking to see whether the issue in  
3 dispute fits within the policy. This is a securities  
4 litigation. It is expressly with an ensuring agreement (a) the  
5 word "securities litigation" is there. If this was a medical  
6 malpractice case against one of these people, it'd be an  
7 entirely different policy, but that's not the issue. That's  
8 what coverage is all about. So we believe, Your Honor, that we  
9 have merited or established a basis to proceed with the  
10 preliminary injunction.

11 As the Court is well aware, we proceeded in the  
12 manner that -- of a preliminary injunction -- as had happened  
13 in WorldCom. We believe we have the basis to prevail. We  
14 believe we've shown the necessary likelihood of success to do so  
15 and given that we are going to face an almost immediate  
16 disruption in defense efforts, we would ask the Court now to  
17 enter the preliminary injunction with the understanding that we  
18 would then be able to address any further issues that the Court  
19 has at a later time.

20 Your Honor, my co-counsel reminds me that to the  
21 extent that the Court is concerned about issues attendant --  
22 dealing with the underlying merits, which we do not believe are  
23 necessary to address in this situation, it is possible for the  
24 Court to stay such portions of this proceeding.

25 As the Court is aware, this is a request for



1 partial relief. That is what Judge Cote was looking at. It's  
2 not a request for complete relief. It's a request for  
3 advancement. Thank you, Your Honor.

4 THE COURT: Okay.

5 MS. GILBRIDE: Your Honor, in view of the Court's  
6 ruling on the prior motion, I believe that this issue of  
7 advancement should be left for another court. Since Your Honor  
8 has deferred this litigation to another court, we're clearly  
9 going to be in front of another court on this coverage issue  
10 and I think in view of the Court's ruling on the director  
11 defendants' motion that the Court should not rule on the  
12 preliminary injunction hearing before it.

13 Be that as it may, with respect to the preliminary  
14 injunction, we think that there's a very high standard that the  
15 insureds must get past in order to get a preliminary injunction  
16 with respect to defense costs. We don't think they've even come  
17 close to satisfying that. They have not established  
18 irreparable harm. They've not even tried to establish  
19 irreparable harm.

20 We don't think that they can establish the  
21 likelihood of success on the merits. Whether it's a substantial  
22 likelihood or not, you know, we believe that it would be a  
23 substantial likelihood that they have to establish because we  
24 do believe that this is a mandatory injunction that they're  
25 seeking and seeking to change the status quo. The status quo

1 right now and has been for the past year is that Axis has  
2 denied coverage for this case.

3 With respect to the merits of Axis's coverage  
4 position, the policy language before Your Honor that's at issue  
5 in this hearing is not the language that was before the Court  
6 in the WorldCom hearing or in any of the -- the Kozlowski  
7 hearing. It was not the language that was at issue in any of  
8 those cases.

9 Axis's language clearly states that they have to  
10 advance only "covered" defense costs and the argument that's  
11 being advanced by the insureds simply ignores that language.  
12 There's another section of the policy --

13 THE COURT: Well, I think they're saying that if  
14 you interpret it the way Axis wants, then, in fact, the other  
15 language that you're -- I think you're about to quote to me --  
16 would be superfluous, which is, you know, fundamental contract  
17 interpretation doctrine that you should never render another  
18 provision superfluous, but --

19 MS. GILBRIDE: I think if you look at the entirety  
20 of Section (d) it's clear that that language is not superfluous.

21 It starts out by saying that Axis will advance covered defense  
22 costs. It then goes on to talk about if Axis advances defense  
23 costs and ultimately they're not covered that they're ripe --  
24 they're subject to recoupment by Axis. That's for the situation  
25 where there is an exclusion upon which an insurer reserves

1 rights, for example, a fraud exclusion that requires an  
2 adjudication of fraud. In that circumstance, the insurer would  
3 reserve rights subject to a final adjudication of fraud and  
4 then seek to recoup those defense costs at the end of the  
5 litigation of the underlying case.

6 Section (d)(3), which is the allocation provision,  
7 must also be considered in this context and the allocation  
8 provision clearly says that if there's a dispute as to covered  
9 and uncovered claims, the parties have to exercise best efforts  
10 to come to a determination. But if they cannot, then Axis must  
11 only advance undisputed defense costs and --

12 THE COURT: I probably opened up a can of worms,  
13 because I -- not that I'm not fascinated by these contract-  
14 interpretation points -- but because I think the ultimate issue  
15 here is -- well, they're not making a motion for summary  
16 judgment based on interpretation of the insurance policy. It's  
17 his motion for an injunction, so --

18 MS. GILBRIDE: I --

19 THE COURT: -- I understand.

20 MS. GILBRIDE: Okay. So, Your Honor, our position  
21 is that based on your prior ruling, we don't believe that Your  
22 Honor should rule on this motion for preliminary injunction,  
23 but if you do, we don't believe that they've satisfied the  
24 procedural threshold for recovery under Rule 65.

25 If Your Honor was so inclined to grant relief our

1 position is that Axis would request that there be a bond  
2 established by the insureds that are seeking this relief that  
3 would provide some assurance for Axis to recover in the event  
4 that ultimately at the end of the day Axis prevails in its  
5 coverage position.

6 THE COURT: Okay.

7 MS. GILBRIDE: Thank you, Your Honor.

8 MR. GOLDMAN: I will not repeat myself.

9 Your Honor, two items: (1) the papers make this  
10 point clear. If Axis', I would say, strained interpretation of  
11 the word "covered" were considered by the Court to be a valid  
12 interpretation that would merely create an ambiguity we are  
13 right in the situation of the Adelphia / Regis case: that  
14 ambiguity should be construed in favor of the insured. But in  
15 any event what we would like to stress for the Court is that  
16 the urgency given that the Lexington policy exhausted in mid-  
17 July of not having a disruption of the defense costs or the  
18 reason we've sought injunctive relief and the language -- we  
19 would be very happy to have the Court refer the underlying  
20 coverage dispute that we will undoubtedly have with Axis and  
21 the duty of theirs to step up and ultimately pay the covered  
22 policy referred to Judge Lynch but we are requesting that this  
23 Court rule on our preliminary injunction at this time in our  
24 favor in order to avoid a disaster.

25 THE COURT: All right.

1 MR. GOLDMAN: Thank you, Your Honor.

2 THE COURT: Okay. Did someone else want to speak?

3 MR. EISEN: Your Honor, Norman Eisen from  
4 Zuckerman, Spaeder on behalf of the officer defendants who are  
5 the indicted defendants as well. I'll be very brief.

6 THE COURT: Okay.

7 MR. EISEN: But we joined in the motion and if I  
8 may just add a couple of points just to emphasize Mr. Goldman's  
9 points which are even more acute as to the three defendants.  
10 We are facing trial in March. The trial was continued from  
11 October because of the enormous amount of discovery that needs  
12 to be reviewed, so it is an even sharper dilemma for us. We  
13 would submit that the question is the Court having resolved the  
14 choice of law question and the applicability of New York law  
15 that under the WorldCom case it's a straightforward issue. The  
16 Court can't split this off in the same sense that the previous  
17 advancement questions have by consent come before the court on  
18 a lis se [sic] posture. There's a narrow issue here that the  
19 Court can separate off comfortably within the scope of its  
20 jurisdiction and refer the rest elsewhere and --

21 THE COURT: Well, I can't refer anything.

22 MR. EISEN: Understood. The rest can go elsewhere  
23 but there is an independent basis for the Court to say, I will  
24 address this narrow question. It is, given the Court's  
25 previous rulings, a straightforward one we think and let the

1 parties go off to resolve the issues where they may. Opposing  
2 counsel has made clear that Axis will not pay. It was  
3 virtually the first statement that was made. It doesn't  
4 believe that this is covered. Months have passed since the end  
5 of May when the complaint was filed. These issues have been  
6 joined and have been before the Court on motions for almost two  
7 months, as you know, Your Honor is more familiar with the  
8 WorldCom case than I am, there was a substantial lapse of time  
9 there while these jurisdictional issues were resolved and I  
10 think on behalf of all the defendants who are very actively  
11 engaged in this civil and/or criminal litigation, but  
12 particularly the ones who are facing the criminal issues, Your  
13 Honor would really be exercising the Court's equity  
14 jurisdiction to address this narrow question and leave the  
15 parties to address the larger coverage issues in another forum  
16 and with that I will -- unless the Court has any questions for  
17 me I'll be seated.

18 THE COURT: No, that's okay. Thanks.

19 MR. EISEN: Thank you, Your Honor.

20 MR. GOLDMAN: I apologize to the Court. Your  
21 Honor, may I ask the Court's indulgence --

22 THE COURT: You get the last word.

23 MR. GOLDMAN: Thank you.

24 I just wanted to add for the Court that I had  
25 realized before and should have mentioned that I -- yes, I

1 don't think that referral here is actually the option. The  
2 counterclaim is pending. It's my understanding that the Court  
3 does not believe at present it lacks subject matter  
4 jurisdiction as to the issues raised by the counterclaim, and  
5 so I would on that basis indicate to the Court that since the  
6 counterclaim is pending and I believe the Court does have 1334  
7 subject matter jurisdiction, that is a basis for the Court to  
8 consider the preliminary injunction and grant it.

9 THE COURT: I.e., what you're saying is, if I  
10 dismiss the adversary proceeding you'd still have a separate  
11 proceeding pending?

12 MR. GOLDMAN: Absolutely, Your Honor, that's what  
13 the counterclaim is there for.

14 THE COURT: Well, what about the issue about  
15 likelihood of success on the merits?

16 MR. GOLDMAN: I believe that we have shown that we  
17 would likely be able to prevail on the merits in the manner  
18 that Judge Cote has described and as we have discussed at  
19 length this morning.

20 THE COURT: Because your argument is, I would have  
21 not to get into whether there was a fraud or not because it's  
22 simply a matter of contract interpretation.

23 MR. GOLDMAN: Correct, Your Honor, as to the  
24 advancement obligation. Ultimately, there will be a  
25 determination before Judge Cote --

1 THE COURT: Right, as to the advancement issue.

2 MR. GOLDMAN: Exactly.

3 MR. KLINE: Your Honor, may I just be heard to  
4 supplement one point, and I apologize. Ivan Kline for Friedman  
5 & Wittenstein.

6 Part of what's in our counterclaims is the fact  
7 that even if Mr. Bennett's knowledge is shown we still have  
8 coverage and we can adjudicate that and none of the issues  
9 relevant to that will be before any other court because the  
10 policy provisions or document relied upon by Axis is simply not  
11 part of the policy. The warranty is not part of the policy and  
12 a prior knowledge exclusion is not in the policy. Those have  
13 nothing to do with Mr. Bennett's knowledge and will not be  
14 adjudicated anywhere else, there will be no discovery in any  
15 other case that relates to those issues. That's what our  
16 counterclaims are largely premised on. Even if one assumes  
17 knowledge or it's shown elsewhere, we still have coverage.  
18 This Court, really, is the right court and as of now the only  
19 court that can adjudicate our position on that and those are  
20 what support our advancement request.

21 MS. GILBRIDE: Your Honor, thank you for allowing  
22 me to have the last word. I hope it is the last word. But,  
23 frankly, what I'm hearing is that the insureds want to have  
24 their cake and eat it too. Your Honor has shown a disposition  
25 to dismissing the action because you believe there's a



1 substantial overlap in the issues. The counterclaims are based  
2 on the very same disputed facts and disputed issues that are  
3 asserted in our claim.

4 THE COURT: See, let's explore that for a second.  
5 They're saying that they're not because for them to win on the  
6 -- they're saying for this advancement-of-cost issue all I have  
7 to do is interpret the insurance policy as to what those  
8 provisions that you and I went through mean as opposed to  
9 finding that in fact they were triggered. For you to win you  
10 have to prevail on both issues. You have to find that they  
11 were triggered, too. You have to convince the Court that they  
12 were triggered.

13 MS. GILBRIDE: Your Honor, in order for them to  
14 prevail on their counterclaims they have to show that their  
15 claims are covered claims.

16 THE COURT: I know but that begs the question --  
17 that has me assuming your interpretation of the contract is  
18 right.

19 MS. GILBRIDE: Well, Your Honor, you only get to  
20 that interpretation -- I think in order to get to that issue  
21 you need to determine whether or not the underlying claims --  
22 it's the cart and the horse here. I mean --

23 THE COURT: But why is that? Why would I need any  
24 discovery as to what any of these defendants knew about the  
25 alleged fraud if in fact the duty to advance defense costs is

1 something that has to wait for -- I'm sorry -- doesn't have to  
2 -- your client's being relieved of the duty to advance defense  
3 costs has to await a final determination on the merits that  
4 it's a funding mechanism as opposed to an ultimate liability  
5 mechanism?

6 MS. GILBRIDE: But, Your Honor, our position is  
7 that it is --

8 THE COURT: Well, I know that's your position, but  
9 in terms of deciding the issue it doesn't really implicate the  
10 substantial overlap doctrine. I'm not sure it does.

11 MS. GILBRIDE: I believe it does, Your Honor, and  
12 I believe it's fundamentally unfair --

13 THE COURT: But why?

14 MS. GILBRIDE: Because basically our position is  
15 that the claims are not covered and you have to determine that  
16 by looking at the underlying acts and finding whether or not  
17 the warranty applies and whether or not the prior knowledge  
18 exclusion applies. I think that you can't do one without the  
19 other, Your Honor.

20 THE COURT: They could prevail without that; it's  
21 just that only you have to win on both points. They could win  
22 on one.

23 MS. GILBRIDE: But for them to win on one there  
24 has to be an excision of a word from the insurance policy, the  
25 word "covered" --

1 THE COURT: Well, but again, that's the --

2 MS. GILBRIDE: -- and I don't think Your Honor --  
3 respectfully, I don't think Your Honor can make a determination  
4 without getting into the facts on that regardless --

5 THE COURT: But what facts? I mean either it's  
6 not ambiguous and it's based on the plain meaning of the  
7 document or it's somewhat ambiguous but construed against the  
8 insurer or the insurer is able to say, well, even if you  
9 construe it against me it's still --

10 MS. GILBRIDE: I think in order to grant a  
11 preliminary injunction, Your Honor, you have to get the  
12 substantial likelihood of success on the merits and I don't  
13 think --

14 THE COURT: But isn't -- again, I confess what --

15 MS. GILBRIDE: Mr. Goldman.

16 THE COURT: No. No, that was --

17 MS. GILBRIDE: Mr. Kline. Mr. Eisen.

18 THE COURT: No. I'm going somewhere else.

19 MS. GILBRIDE: Okay.

20 THE COURT: When I read your argument about the  
21 defendants taking inconsistent positions I kind of dismissed  
22 that right away because it was in the context of the motion to  
23 dismiss and, clearly, Mr. Walsh's clients weren't taking  
24 inconsistent positions. So I didn't even think about it,  
25 whether they were inconsistent or not, but I'm not sure they

1 are inconsistent. I mean Mr. Walsh's clients want your claim  
2 dismissed, but even if you hadn't made that claim wouldn't any  
3 beneficiary of this policy have a right to start a lawsuit  
4 saying that you've wrongfully failed to pay?

5 MS. GILBRIDE: Yes, of course --

6 THE COURT: Now, I thought that wasn't truly ripe  
7 -- when I came into this I thought that wasn't truly ripe -- in  
8 the real term of ripeness, because other than saying you want  
9 me to determine whether you don't have to pay you hadn't said  
10 "we won't pay," but I thought I heard you say at the beginning  
11 of this hearing --

12 MS. GILBRIDE: We said --

13 THE COURT [to Ms. Kim]: I'll do the talking.

14 MS. KIM: Sorry.

15 THE COURT: I thought I heard you say at the  
16 beginning of this hearing, no matter whether you dismiss or not  
17 "we won't pay," and that makes it ripe to me, I think. I mean  
18 if Axis is saying literally today, we're not going to go back  
19 and rethink this and consider whether -- now that Judge Drain  
20 is not going to decide for us whether we have to pay or not,  
21 whether we're going to take the risk of not paying -- which,  
22 you know, is certainly a legitimate thing for an insurer to do.

23 It's one thing to act unilaterally, it's another thing to ask  
24 a court for a determination of whether they're acting properly.

25 At this point Axis would be acting unilaterally. That raises

1 some fairly serious issues, you know, and maybe creates  
2 potential liability beyond the coverage so -- but if you're  
3 telling me today Axis has already made that decision, it's  
4 going to act unilaterally and not withhold the money, then this  
5 is ripe.

6 MS. GILBRIDE: Your Honor, I can't make a  
7 representation one way or the other about what Axis will do  
8 because we didn't know what your ruling was going to be and so  
9 --

10 THE COURT: Well, no, but I thought you told me --  
11 I mean I don't have a court reporter here, we're on electronic  
12 transcript -- at the beginning of the hearing that --

13 MR. BORGEEEST: Your Honor, Wayne Borgeest on  
14 behalf of Axis. May I be heard briefly?

15 THE COURT: On behalf of?

16 MR. BORGEEEST: Axis.

17 THE COURT: Okay.

18 MR. BORGEEEST: If I may, Your Honor, Axis denied  
19 coverage over a year ago so the company staked out its position  
20 well over a year ago. The position --

21 THE COURT: Yes, but at that point it didn't  
22 really matter. I mean you could always change your mind --

23 MR. BORGEEEST: Well, no --

24 THE COURT: No one was asking you for money then.

25 MR. BORGEEEST: Well, I think it did matter. I

1 think that counsel was free to bring --

2 THE COURT: Do you really want to say that?

3 MR. BORGEEEST: Counsel was free to challenge --

4 THE COURT: I mean --

5 MR. BORGEEEST: Your Honor, Axis did not get so  
6 much as a letter disputing the denial.

7 THE COURT: But --

8 MR. BORGEEEST: I think what the counterclaim  
9 defendants are saying is that for purposes of your jurisdiction  
10 it's okay for them to prove that their clients were wrongly  
11 treated but in denying us our prosecution of our complaint for  
12 declaratory judgment of no coverage you're not allowing us to  
13 prove that we are correct in our position and that obviously is  
14 an absurd result.

15 THE COURT: It's not, I don't think so. I'm  
16 sorry, I beg to differ because it's two different issues.

17 MR. BORGEEEST: No, but we filed an action for a  
18 declaration of the Court --

19 THE COURT: Right.

20 MR. BORGEEEST: -- that there's no coverage for  
21 these individual insureds.

22 THE COURT: I understand and --

23 MR. BORGEEEST: They have counterclaimed saying  
24 that there is coverage for their insureds.

25 THE COURT: No, they have not. They have

1 counterclaims saying that your client has to advance defense  
2 costs.

3 MR. BORGEEEST: That's correct.

4 THE COURT: And they have a different  
5 interpretation of the contract than your client has.

6 MR. BORGEEEST: But, Your Honor.

7 THE COURT: They say that that provision is a  
8 funding mechanism subject to recoupment or reimbursement. You  
9 say it's a coverage issue.

10 MR. BORGEEEST: With all due respect, Your Honor,  
11 Your Honor cannot --

12 THE COURT: With all due respect I read it and  
13 that's what it says.

14 MR. BORGEEEST: But, Your Honor, with all due  
15 respect the Court cannot find that there is a funding  
16 obligation without finding that there is coverage.

17 THE COURT: I disagree completely.

18 MR. BORGEEEST: Well, then we have a disagreement  
19 but --

20 THE COURT: I can't find that there is no funding  
21 obligation without finding that the insurer has no underlying  
22 liability, but in terms of the issues as to the meaning of the  
23 contract and what the provisions mean, as far as coverage and  
24 the reference to "finally determined," that has nothing to do  
25 with the evidence that's going to be coming out in the

1 litigation in the District Court.

2 MR. BORGEEEST: But, Your Honor, how can the Court  
3 find that there's a funding obligation in the face of a claim  
4 which you now want us to take over to another courthouse where  
5 we are going to prosecute the claim to find that there is no  
6 coverage?

7 THE COURT: Oh, no, this litigation would have to  
8 be limited to a fairly narrow set of issues. It would not get  
9 into that issue.

10 MR. BORGEEEST: Your Honor, we're being put in a  
11 very awkward position. We responded to the motion to dismiss  
12 by saying that we would litigate our coverage issues in a  
13 narrow fashion without burdening the underlying securities  
14 litigation. Your Honor has given an indication that you're  
15 inclined to reject that --

16 THE COURT: Because it wouldn't happen.

17 MR. BORGEEEST: -- because of the overlap.

18 THE COURT: Right.

19 MR. BORGEEEST: If there's overlap for our claim  
20 for a declaration of no coverage there necessarily must be  
21 overlap with their declaration of some claim that funding in  
22 the absence of a determination of coverage.

23 THE COURT: All right. I thought you were going  
24 to stand up to say something completely different which is that  
25 this isn't ripe --



1 MR. BORGEEEST: I'm sorry, Your Honor.

2 THE COURT: -- and the insurer has really not made  
3 up its mind, but I think we're just repeating the same  
4 argument.

5 So, is the insurer saying it's not going to pay or  
6 not?

7 MR. BORGEEEST: Your Honor, the insurer issued a  
8 denial letter well over a year ago that went unchallenged.

9 THE COURT: I understand that, but there's -- I  
10 also understand that there's a big difference, and potentially  
11 a legal difference as far as the insurer's liability, when push  
12 really comes to shove and the request is made, because they  
13 need the money -- they've gone through the first layer of  
14 excess -- that it really won't fund, because that's when the  
15 damages start and that's when penalties start for the insurer.  
16 So that's a very serious decision for an insurance company to  
17 make.

18 MR. BORGEEEST: It is and that's the reason why we  
19 filed a declaratory judgment action --

20 THE COURT: I understand, and that's why I thought  
21 the insurer was deciding to act not unilaterally but to try to  
22 get a judicial determination, and I don't fault you for that.  
23 That's a good thing. That's what responsible parties do; but,  
24 although I had not decided this until preparing for this  
25 hearing, it's not going to work here. I can't give you that

1 determination. So now you have to decide whether you're going  
2 to act unilaterally -- in which case I think this motion is  
3 ripe -- or not, and I'm happy to give you a little time to  
4 decide that.

5 MR. BORGEEEST: Your Honor, we're prepared to  
6 litigate the issue of coverage. That's why we're here. The  
7 contract itself by its terms --

8 THE COURT: You lost on that point.

9 MR. BORGEEEST: Okay. Let me turn to another point  
10 then.

11 THE COURT: Okay.

12 MR. BORGEEEST: The contract by its terms gives  
13 Axis the unilateral right to determine how much of the defense  
14 costs are covered and how much it will pay. Contractually, it  
15 gives Axis that right unilaterally.

16 THE COURT: I am happy to determine those issues  
17 here -- those contract interpretation issues if you're telling  
18 me that if I don't determine them you're going to withhold  
19 coverage.

20 MR. BORGEEEST: Your Honor, we came here, filed  
21 this action prepared to litigate the contract issues. All  
22 we're saying is you can't litigate some and not all.

23 MS. GILBRIDE: Your Honor, you're asking us to go  
24 to another courthouse to litigate this.

25 THE COURT: No, I'm asking you to tell me whether

1 in fact your client's going to pay or not. If they're not,  
2 then I think this is ripe. If they are going to advance  
3 defense costs or they're considering it, it's either not ripe  
4 or I'll give your clients some more time to consider this  
5 issue.

6 MS. GILBRIDE: Our position has consistently been  
7 that we're not going to advance defense costs in the absence of  
8 a judicial determination that we must. Our policy says that we  
9 -- it says that we must advance covered defense costs.

10 THE COURT: Okay. Then I believe this issue is  
11 ripe. So I have been persuaded -- Mr. Goldman has persuaded me  
12 that I should dismiss the underlying action brought by Axis but  
13 keep the counterclaim on the docket.

14 It seems to me as a practical matter it may make  
15 sense to move to withdraw the reference of this matter, but  
16 that's not something I can do. I also need to know -- because  
17 there's no record here really -- as to when these costs are  
18 going to kick in.

19 MR. GOLDMAN: Your Honor, they've already kicked  
20 in. We have bills that were submitted to Axis approximately  
21 two weeks ago for July-time because the Lexington policy  
22 exhausted with the payment of June-time so they have the bills,  
23 we're waiting for payment.

24 MR. KLINE: I don't believe this is a dispute,  
25 Your Honor.

1 MS. GILBRIDE: That's correct.

2 THE COURT: There are outstanding bills? How  
3 much?

4 MS. GILBRIDE: Approximately \$2 million has been  
5 submitted to us in the past month.

6 THE COURT: And when were they submitted?

7 MS. GILBRIDE: Plus, there's been a settlement  
8 demand tendered to the carrier.

9 THE COURT: When were the bills submitted?

10 MS. GILBRIDE: Over the course of the last several  
11 weeks.

12 THE COURT: Well, we're really just talking about  
13 the defense costs here; right? Because the settlement demand  
14 is going to be subject to a fairness hearing, notice to the  
15 Refco Trustee and the like. That money is not going to come  
16 out-of-pocket for quite some time.

17 MR. GOLDMAN: That's correct, Your Honor.  
18 Obviously, Judge Lynch would have to have an approval on that  
19 in accordance with Rule 23.

20 THE COURT: What is your response on the bond  
21 point?

22 MR. GOLDMAN: In brief, Your Honor, it turns the  
23 policy upside down. They're asking us to be their insurer.  
24 The policy terms are express. I don't think there's any  
25 difficulty interpreting it as exactly as the Court has

1 identified it, a funding vehicle. It would be the same as  
2 every --

3 THE COURT: Well, no, I was just identifying the  
4 issue not -- I wasn't --

5 MR. GOLDMAN: I understand. I understand, Your  
6 Honor. It would be the same as asking every automobile  
7 accident person to bond the costs until the insurer decides  
8 whose liable. It doesn't work that way. That's what insurance  
9 is for. That's what the particularity of an insurance contract  
10 is all about. It's their obligation to assume that risk and  
11 contractually we would assert we will convince this Court that  
12 they assume precisely that risk with the language that they  
13 drafted.

14 THE COURT: Is the discovery -- has there been any  
15 change in the intensity of the litigation in terms of the  
16 incurrence of legal fees and the like?

17 MR. GOLDMAN: I'm sorry, the securities  
18 litigation, Your Honor?

19 THE COURT: Yes.

20 MR. GOLDMAN: Yes, discovery started.

21 THE COURT: And there's no like hiatus or anything  
22 like that, it's moving ahead?

23 MR. GOLDMAN: No. We're not in hiatus world, Your  
24 Honor. We're in an incurring debt world.

25 THE COURT: And you say the criminal trial is now

1 on for March?

2 MR. EISEN: Yes, Your Honor, and there has been, I  
3 think -- because we were set initially for October -- there was  
4 a very intense period which I think is some of what's in the  
5 pipeline as a result of the continuance. I know I was able to  
6 take my summer vacation, so I think that there has been some  
7 lessening there, although obviously we're going to need to get  
8 ready for that as well.

9 THE COURT: You've agreed upon the amount of the  
10 legal bills that have been submitted?

11 MS. KIM: Your Honor, the practice has been that  
12 the parties simply submit the bills to the carrier and there  
13 has not been any requirement of consent or --

14 THE COURT: No, I'm not talking about consent,  
15 just literally what the amount is of the bills.

16 MR. KLINE: Your Honor, no one of us would have  
17 any way to know the total because --

18 THE COURT: No, I thought you might have conferred  
19 among --

20 MR. KLINE: No. We only see our own. Only Axis  
21 would know the --

22 MS. KIM: Yes. All we do, Your Honor, is submit  
23 the bills and we understand it's a first come/first serve basis  
24 and then they let us know when it's exhausted. That's exactly  
25 what happened with the U.S. Specialty and the Lexington

1 policies.

2 THE COURT: But you say it's about \$2 million?

3 MS. GILBRIDE: Yes, Your Honor. I mean we've just  
4 gotten the bills in, so they haven't been the subject of any  
5 sort of a review for what's been incurred but that's the gross  
6 amount.

7 MR. CASHMAN: Your Honor, I'm sorry, I haven't  
8 spoken yet. This is Richard Cashman. We represent one of the  
9 officer defendants, Philip Silverman, and I just wanted to  
10 respond to Your Honor's question, and that is there are bills  
11 that are coming, as well, because there has been a lot of  
12 activity in these cases.

13 MS. KIM: What do you recommend [sic]?

14 THE COURT: Well, it seems to me that on the issue  
15 of the contract interpretation one could get to that issue very  
16 quickly. It's a matter of contract interpretation and  
17 consequently unless someone has a different view I should not  
18 be thinking here about a lengthy injunction and if it is to be  
19 teed up here it should be teed up promptly.

20 I continue to think, although this is beyond my  
21 power, that given the existence of a securities action and the  
22 inevitable tie-ins to settlements that a district judge might  
23 want to have the reference but that's not for me to decide.

24 I also know that law firms generally are prepared  
25 to wait a little bit for payment of their bills. So I'm really

1 focusing on the ones that have been billed and not on some sort  
2 of general green light for anything coming due over the next  
3 several weeks or months. But I am prepared to conclude on the  
4 basis of my review of the general principles set forth in the  
5 WorldCom case with regard to how courts look at provisions in  
6 indemnity policies in respect of the advancement of defense  
7 costs, as well as the particular language at issue here on Page  
8 8 of the policy, that as far as the "merits" aspect of a motion  
9 for a preliminary injunction is concerned there is either a  
10 substantial likelihood of success on the merits or -- and I  
11 strongly emphasize the "or," because this is more where I'm  
12 focusing -- sufficient questions going to the merits which in  
13 light of the balance of the harms here would mean that on the  
14 issue of the merits the movants have sustained that prong of  
15 their request for a preliminary injunction. Going to the  
16 "harms," although it is asserted -- and I accept this -- that  
17 certain of the defendants are wealthy individuals, the amount  
18 of the defense costs here -- \$2 million -- following upon the  
19 primary carriers' coverage limits being exceeded tells me that  
20 these are extremely substantial defense costs that need to be  
21 incurred as part of this schedule that's been set out by the  
22 various courts -- the criminal court in particular, but also  
23 the district court in the securities litigation -- and that to  
24 run the risk of not having counsel proceed or to substantially  
25 cut back upon their efforts because of unpaid bills is a



1 tremendous potential harm, particularly in a criminal context  
2 (and I note that as Judge Gerber has in the Adelphia case,  
3 there is a significant distinction between an indictment and a  
4 conviction and the criminal trial is at the trial stage, not  
5 the appellate stage).

6           That leaves, I believe, the issue initially raised  
7 by counsel for Axis, and pressed by counsel for Axis, that a  
8 ruling granting the request for a preliminary injunction is  
9 fundamentally inconsistent with a ruling dismissing Axis'  
10 underlying case, which obviously I just issued. I do not  
11 believe that it is inconsistent with that ruling or unfair to  
12 Axis. As I noted before, for Axis to prevail in its  
13 declaratory judgment action it needs to prove two things: one,  
14 it needs to prove that its interpretation of the contract --  
15 the insurance policy -- as well as potentially the related  
16 warranty, is the right interpretation, the correct  
17 interpretation. That is not a matter that substantially  
18 overlaps with litigation anywhere else. In particular, it  
19 doesn't substantially overlap with litigation in the District  
20 Court in the securities law action or with litigation in the  
21 criminal action. However, if Axis' interpretation of the  
22 contracts as they apply to the duty to advance defense costs is  
23 incorrect, then the plaintiffs on the cross-claim or the  
24 counterclaim prevail as far as the defense costs advancement  
25 issue is concerned. Therefore, it seems to me that those

1 issues -- those contract interpretation issues -- are discrete  
2 and can be decided by me. As I noted, Axis needs to win two  
3 things in order to not advance defense costs, however. In  
4 addition to having its interpretation of the contract prevail,  
5 it also has to convince a Court that the exclusions or its  
6 right to rescind or its right under the warranty, so-called,  
7 have been triggered, and that is what overlaps as I have  
8 previously found, with the District Court litigation in the  
9 criminal case. But it seems to me the plaintiffs' claim here --  
10 and the only plaintiffs that would be left would be the  
11 counterclaim plaintiffs -- is not subject to that problem and  
12 can go forward. As you can tell from my earlier remarks, I  
13 toyed with the idea of somehow putting this off or delaying it  
14 so that the whole matter could be joined with the District  
15 Court litigation, because I think that in terms of settlement  
16 and the like that may make sense, but that's not something I  
17 can do, and I do have an obligation to exercise my jurisdiction  
18 unless it's withdrawn from me, except where the law requires me  
19 not to as in the "substantial overlap" case law. And so, there  
20 having been a counterclaim filed which can survive as the only  
21 claim in this adversary proceeding, I have jurisdiction to  
22 determine the motion for a preliminary injunction. I don't  
23 believe that it is unfair to exercise that jurisdiction here or  
24 inequitable, and, therefore, the equitable relief sought can  
25 and should be granted.

1           There has been a request for a bond to be posted,  
2 but as Mr. Goldman said and as I believe the case law provides,  
3 that would be tantamount to advancing one's own defense costs  
4 and contrary to the case law.

5           So let me be clear: as I said before, it seems to  
6 me that the injunctive relief that I'm ordering here should be  
7 limited to bills that are outstanding; and I believe this is  
8 the case, but I want to be clear -- I am doing nothing more  
9 than saying that. The insurer, Axis, is directed to advance  
10 defense costs based upon the beneficiaries' definition of or  
11 interpretation of the provisions on Page 8 requiring  
12 advancement, i.e., if there are other provisions, or to the  
13 extent there are other provisions, of the insurance policy that  
14 apply to the advancement of defense costs other than the issue  
15 that's been teed up here -- i.e., whether there needs to be a  
16 final determination or not -- I'm not overwriting those  
17 provisions. This just goes to the dispute as to whether there  
18 needs to be a final determination of coverage or not related to  
19 the advancement of defense costs. So, for example, if Axis has  
20 the ability to review for reasonableness or the like under the  
21 insurance policy, that's not being overridden by this ruling.  
22 The only thing that Axis is being directed to do is to comply  
23 with the provision that requires defense costs to be advanced,  
24 subject to the final determination, and we should schedule the  
25 final hearing on this promptly, which I view to be a matter

1 that can be decided based on review of the contract unless  
2 someone else tells me otherwise.

3 The parties have obviously done a lot of briefing  
4 on the merits already of that issue.

5 MR. GOLDMAN: Yes, Your Honor.

6 THE COURT: So if we did this --

7 MR. GOLDMAN: Your Honor, just one moment.

8 [Pause in proceedings.]

9 MR. GOLDMAN: Your Honor, having conferred with  
10 the small group of co-counsel we have here I think our  
11 assessment is certainly if Axis wishes to file in a further  
12 brief on the contract interpretation issue which we have always  
13 felt is the narrow issue we have been presenting we would then  
14 file a responsive brief and we would schedule with the Court's  
15 cooperation as early as the latter part of September for a  
16 further hearing on this.

17 THE COURT: It would be on a motion for a summary  
18 judgment though; right?

19 MR. GOLDMAN: Yes, Your Honor, we could file a  
20 motion for summary judgment.

21 THE COURT: Or, I guess, a motion to dismiss. It  
22 could be either one. It would really be a motion -- well --

23 MR. GOLDMAN: We'll do a motion for partial  
24 summary judgment. That's what we're going to do.

25 [Other attorneys commenting in the background]

1 MR. GOLDMAN: That's what we're going to do,  
2 narrowed to the issues that the Court has identified we are  
3 focused upon.

4 MS. GILBRIDE: Your Honor, respectfully, on behalf  
5 of Axis we intend to file an immediate appeal of Your Honor's  
6 ruling today.

7 THE COURT: Okay.

8 MS. GILBRIDE: So we would ask that that be  
9 factored into whatever briefing schedule is going to be  
10 established. We understand we have to do that within the next  
11 ten days and we would ask that the order ordering us to advance  
12 defense costs be deferred until we can get an appeal filed with  
13 the District Court.

14 MR. GOLDMAN: I understood that to be a request  
15 for a stay?

16 THE COURT: As long as it's an expedited appeal.

17 MS. GILBRIDE: Oh, we intend to file it, you know,  
18 as quickly as we can.

19 THE COURT: No, no, that you request expedited  
20 treatment --

21 MS. GILBRIDE: Yes, we will. We will, Your Honor.

22 THE COURT: All right. I mean I could actually --  
23 I have a lot going on at the end of September and beginning of  
24 October in various cases but I could give you October 12th just  
25 for your own purposes and you could tell the District Court

1 that.

2 October 12th. Friday.

3 MR. GOLDMAN: Is that after the NCBJ? I believe  
4 it is actually or is it during?

5 THE COURT: I don't know.

6 MR. GOLDMAN: It doesn't --

7 THE COURT: If it is -- I wasn't going to be going  
8 to that.

9 MR. GOLDMAN: I gathered.

10 THE COURT: But I could give you that date.

11 MR. GOLDMAN: One moment if I may, Your Honor.

12 THE COURT: But I am inclined to grant this  
13 request. It seems to me while it's important to deal with the  
14 billing issue -- for a lot of reasons I'm inclined to grant  
15 this request.

16 MR. GOLDMAN: And Your Honor let me make one  
17 comment and then my co-counsel will speak if I may. We have so  
18 much expense coming up. The fear is that this not be  
19 characterized as a stay that the appellate court presumes can  
20 be continued --

21 THE COURT: No, I don't -- that's why I asked for  
22 --

23 MR. GOLDMAN: -- I don't know that ten days  
24 doesn't matter but six weeks does.

25 THE COURT: That's why I requested an expedited --

1 that we'd be conditioning it upon an expedited appeal.

2 MR. KLINE: Your Honor, can I suggest it might be  
3 more appropriate -- we don't mind if they're given ten days to  
4 pay but it should be incumbent upon them to get a stay from the  
5 District Court.

6 THE COURT: But you can do that in ten days.  
7 That's easy to do.

8 MR. KLINE: Right. But absent a stay from the  
9 District Court they should be required to follow Your Honor's  
10 order and pay; otherwise they'll just file and say we don't  
11 have to pay.

12 THE COURT: My view is this issue could be well  
13 teed up for the District Court within ten days, and I think  
14 that's what counsel intended.

15 MR. KLINE: I think with all respect it should --

16 THE COURT: So I will -- it's stayed for ten days  
17 but that's more than sufficient time to put in an appeal.

18 MR. GOLDMAN: I understand.

19 THE COURT: I know lawyers can wait ten days on  
20 payment of their bills but I'm also, as I said, very cognizant  
21 of the fact that the bills are very large and they're going to  
22 be increasing in the future and that this issue on the merits  
23 really needs to be decided very quickly -- this contract  
24 interpretation issue -- and so I'm telling you all that I would  
25 be free on October 12th to hear it, and I think that may be

1 useful for the District Court also, but I'm not going to impose  
2 a briefing schedule on you because the next step of this is  
3 going to be at the District Court; but as everyone now  
4 understands that step has to result in some action by the  
5 District Court within the next ten days or my stay is going to  
6 be gone -- the stay that applies now is going to be gone.

7 MR. GOLDMAN: That's fine.

8 Your Honor, we will be bringing on a summary  
9 judgment motion probably before the District Court -- partial  
10 summary judgment -- but that --

11 THE COURT: All right. But I think the October  
12 date gives people -- particularly given all the work that they  
13 have done on it and, I'm sure, will be doing on it, people will  
14 be reciting these provisions of the insurance agreement in  
15 their sleep and will be well enough prepared for a hearing in  
16 October.

17 MR. GOLDMAN: That already has happened.

18 THE COURT: Okay. That leaves the stay motion.

19 MR. GOLDMAN: The stay motion and I --

20 THE COURT: All right. But before we go to that  
21 you'll need to give me an order --

22 MR. GOLDMAN: Yes.

23 THE COURT: -- and you should do it promptly  
24 because that's what's going to start their appeal, obviously,  
25 and that needs to go forward promptly so --



1 MS. GILBRIDE: There would be two orders, Your  
2 Honor, right?

3 THE COURT: Well, Mr. Walsh is going to give me an  
4 order dismissing the main -- the adversary claim brought by  
5 Axis, and Baker & Hostetler is going to give me an order  
6 granting the preliminary injunction in connection with their  
7 cross-claim, or counterclaim, excuse me.

8 MS. GILBRIDE: Your Honor, if I heard you  
9 correctly the ten days would then start to run from the date  
10 that you sign that order?

11 THE COURT: Well, from the entry of the order.

12 MS. GILBRIDE: Right.

13 THE COURT: No, no, I'm sorry, the ten days on the  
14 --

15 MS. GILBRIDE: To get an expedited --

16 THE COURT: For the injunction? Yes.

17 MS. GILBRIDE: Yes.

18 THE COURT: Yes.

19 MR. GOLDMAN: All right, Your Honor, just because  
20 we have discussed the stay issue at some length I have nothing  
21 further to add. I only wanted to make one -- I'll call it the  
22 tangential point -- one of the reasons why we have sought the  
23 stay modification to the extent it was necessary in light of  
24 the plan confirmation order was precisely because demands to  
25 the insurers need to be made under cooperation provisions in

1 many of these policies for them to put it in line for payment.

2 Obviously, they make their determinations in response but I  
3 certainly did -- that was a primary reason why we wanted to get  
4 this clarification and, of course, it's my understanding that  
5 nothing in today's ruling with respect to the preliminary  
6 injunction motion changes the fact that we would submit a  
7 demand to the insurer. It doesn't mean they're going to pay  
8 it, obviously, but it does mean we have the right to do that.  
9 That's in large part what the lift stay motion is all about.  
10 We have, as I have said, agreed we will provide notice to Mr.  
11 Kirschner regarding our doing so.

12 THE COURT: Okay.

13 MR. KLINE: Your Honor, Ivan Kline from Friedman &  
14 Wittenstein.

15 It's been a long morning and I'll be very brief.  
16 Our only point of our response is really we believe it would be  
17 more appropriate to make sure that a particular settlement is  
18 back before this Court for approval given that this is the  
19 Court that has jurisdiction over the policy and has all the  
20 insureds before it and no other court has that; whether it's in  
21 the context of the stay or not to stay or using your authority  
22 under Section 105 is really less important than we simply  
23 believe that there should be some mechanism whereby a  
24 particular settlement would be subject to this Court's review  
25 and approval to make sure that all of the parties' rights

1 including those of the estate and those of other insureds are  
2 not being prejudiced in any way, and I believe actually in the  
3 letter from Axis that was submitted on their reply even  
4 suggests that whatever the proposed settlement is would be one,  
5 for example, that might prejudice the rights of other insureds.

6 I still don't know what the details are, so it's hard for us  
7 to comment on that, but our point was simply we have no problem  
8 with the concept of the stay being lifted to allow for the  
9 payment of settlements; it's simply that we think it should be  
10 in one form or another, a particular settlement should be  
11 before this Court.

12 THE COURT: Okay. Well, again, I quoted the  
13 language in Paragraph 34(c) of the confirmation order which I  
14 believe enables the beneficiaries of the policies -- not just  
15 the debtor but the other beneficiaries -- to seek and obtain  
16 coverage and payments from those policies.

17 Now, it may be that the consequences of doing that  
18 will affect the debtor in a way that would require some relief  
19 here in terms of either a settlement or 9019 or the other  
20 provisions of the plan but it's hard for me to conceive what  
21 those would be and it seems to me that as long as there is  
22 advance notice, not retroactive notice, but advance notice, of  
23 any proposed settlement, that the plan administrator on behalf  
24 of the estate will be able to protect the estate's rights and  
25 that's, I gather, what Mr. Kirschner has concluded also.

1           It seems to me that the other beneficiaries, to  
2 the extent the settlement involves insurance or -- well, I'll  
3 leave it at that. I mean obviously there are contribution  
4 issues, too, but to the extent a settlement involves insurance  
5 it should get notice of a settlement as far as approval by a  
6 District Court is concerned in the MDL, for example. So I  
7 think as long as there is proper notice to other affected  
8 parties that your concerns are taken into account.

9           MR. KLINE: Your Honor, could I just ask then that  
10 the order that they submit recite that there must be advance  
11 notice, because I believe that the order they submitted calls  
12 for post-disbursement notice --

13           THE COURT: You're right.

14           MR. KLINE: -- which is of no use for the  
15 settlement

16           THE COURT: It needs to be adequate advance  
17 notice.

18           MR. KLINE: And could the other insureds be  
19 included in that so that if we wanted to seek relief in this  
20 Court we could do so? Frankly, I don't think Judge Lynch will  
21 have any interest in hearing the claim of one insured against  
22 another. I think Judge Lynch's only concern in a Rule 23  
23 approval is fairness to the plaintiffs in the class which is a  
24 different issue.

25           So if we could just get that the notices to the

1 plan administrator and the other insureds in advance I think we  
2 would withdraw any objection to their motion.

3 MS. KIM: Well, Your Honor, I'd like to know "in  
4 advance" of what? -- because all that we are seeking here is to  
5 make sure that the automatic stay is not used as some kind of  
6 procedural bar that interferes with the normal course under the  
7 insurance policy for the carrier to determine whether or not a  
8 settlement is reasonable, or not. Obviously, any settlement  
9 would be subject to the consent of the carrier and so what I  
10 don't want to happen is to be required to give notice before  
11 seeking consent or obtaining consent from the carrier -- after  
12 the carrier.

13 THE COURT: You're talking about getting advance  
14 notice of approval by the court presiding over the litigation?  
15 Is that what you're talking about?

16 MS. KIM: Oh, that's fine. We don't have any  
17 problem getting advance notice. Of course, we'd be required to  
18 give notice to the parties to the underlying litigation. They  
19 would get notice just like any other party in terms of  
20 obtaining approval before Judge Lynch on any settlement so I  
21 just want it to be clear on the record what they're seeking.

22 THE COURT: Well, I was asking you. Is that what  
23 you had in mind?

24 MR. KLINE: All I'm asking is whatever advance  
25 notice they promised Mr. Kirschner that we get. I don't know

1 what they meant by advance notice to Mr. Kirschner but it must  
2 be before disbursements.

3 THE COURT: All right. So you're --

4 MR. GOLDMAN: We have no problem with that, Your  
5 Honor. Obviously we will circulate to him and to others an  
6 order. We have to have Mr. Kirschner look at it as well but  
7 that order won't come in today. It will probably come in  
8 tomorrow.

9 THE COURT: Okay. That's fine.

10 MR. GOLDMAN: Your Honor, if I may we had  
11 submitted to the Court a proposed order and as I review it in  
12 respect of the preliminary injunction I think it is consistent  
13 with the Court's ruling except that I would suggest that we  
14 insert -- as it say there, "obligated to pay defense costs," I  
15 would insert "ten days after entry of this order."

16 MS. GILBRIDE: Your Honor, you know, I don't have  
17 that order in front of me at the moment but I believe that's an  
18 order ordering us to advance defense costs on behalf of all  
19 insureds, not just the remaining insureds, No. 1, and I think  
20 there's a reference to future costs in the order as well? I'd  
21 like the opportunity to review it before.

22 MR. GOLDMAN: I think what we'll do is give her a  
23 copy of what I have in my hands, Your Honor, if that's all  
24 right.

25 THE COURT: Well, let me take a look at it first.

1 Let me just take a quick look at it.

2 [Pause in proceedings.]

3 THE COURT: Well, this applies to the defined term  
4 "movants" not all the parties.

5 MR. GOLDMAN: Your Honor, just on -- we have no  
6 objection to it applying to other insureds, just so the Court  
7 understands that.

8 MR. EISEN: Your Honor, if I may, we joined -- the  
9 other defendants joined in so if the Court is inclined -- and  
10 obviously our situation was part of the Court's reasoning. If  
11 the Court is inclined after this order we'd just ask --

12 THE COURT: No, your clients did join in.

13 MS. GILBRIDE: Your Honor, there are no  
14 counterclaims asserted on behalf of his clients. There's no --  
15 they have not answered, they have not asserted counterclaims,  
16 there is no basis for the Court to order advancement of defense  
17 costs on behalf of his clients.

18 MR. WALSH: Nonetheless, Your Honor, there is an  
19 advancement obligation and it seems completely illogical to  
20 make a determination for one and not the other.

21 THE COURT: That's true, but it's also -- it's  
22 procedurally -- you can make a motion promptly but there's no --  
23 --

24 MS. GILBRIDE: They made a motion to dismiss.

25 THE COURT: No, no, they made a motion to dismiss

1 your client's claims but the only motion for a preliminary  
2 injunction before me and the only counterclaim before me is --

3 MR. WALSH: We understand that, Your Honor, so if  
4 that's what Axis requires that we go through all the procedural  
5 --

6 THE COURT: Well, it's what I require.

7 MR. WALSH: Okay. Then we'll do that.

8 THE COURT: And the same for the criminal  
9 defendants.

10 MR. EISEN: Your Honor, our joinder in the  
11 existing motion --

12 THE COURT: That's not sufficient.

13 MR. EISEN: Just to be clear, so what does Your  
14 Honor require? That additional counterclaims --

15 THE COURT: On an adversary proceeding basis,  
16 which is what the counterclaim was, you need to start an action  
17 for advancement of defense costs and seek preliminary  
18 injunctive relief.

19 MR. EISEN: Your Honor, is it sufficient to -- you  
20 know, the posture that we were in up to this point was we had  
21 joined in the motion to dismiss so there was no pleading  
22 requirement for us before today. Pleading is held in -- it was  
23 the motion to dismiss the insurers' claims and we did join in  
24 the motion for preliminary injunction so --

25 THE COURT: But, procedurally, I'm not comfortable



1 with that.

2 MR. EISEN: Just so I understand the parameters of  
3 that, if that is filed around the representation that's going  
4 to be filed may we be included or can we within that ten day  
5 period of the order are we going to need to submit --

6 THE COURT: No. I think you're going to need to  
7 go through the procedural hoops.

8 MR. EISEN: Will that require an additional  
9 hearing or can we just submit those -- I only ask that question  
10 --

11 THE COURT: I don't know. I'll have to decide  
12 that. I don't know. I would find it unlikely, but let me read  
13 the pleadings.

14 MR. EISEN: Thank you, Your Honor.

15 THE COURT: Okay. They're all different. Your  
16 clients, although I doubt it, might be multi-millionaires or  
17 multi-multi-millionaires. I don't know. I know one of Mr.  
18 Walsh's clients is.

19 MR. WALSH: Was that taking inflation into  
20 account, Your Honor?

21 THE COURT: No. No, they're not. They're not.  
22 They're not withdrawing it.

23 MS. GILBRIDE: So you could dismiss the action.  
24 They're not even parties.

25 THE COURT: No, I said they can start their own

1 action and as part of that adversary proceeding seek injunctive  
2 relief.

3 MS. GILBRIDE: It's slightly inconsistent.

4 THE COURT: Well, I've already ruled on that.

5 MR. EISEN: Your Honor, at the risk of delaying  
6 things may I quickly suggest another alternative that I think  
7 would be easier for the Court which is to allow us the option  
8 of intervention as opposed to filing independent adversary  
9 proceedings?

10 THE COURT: I'm not aware of such an option.

11 MR. EISEN: Okay.

12 THE COURT: I'm just not. So somehow you need to  
13 tee it up so that it's before me as far as an affirmative  
14 claim.

15 MR. EISEN: Understood and if we're able to puzzle  
16 out another basis that we believe --

17 THE COURT: I'm not precluding you from puzzling  
18 out another basis.

19 MR. EISEN: Thank you, Your Honor.

20 THE COURT: Okay. So by movants here -- the  
21 defined term "movants" is just your clients; right?

22 MR. GOLDMAN: The five that are named in the  
23 motion.

24 THE COURT: Right. It's not those who joined in  
25 the motion or anything like that?

1 MR. GOLDMAN: That's correct. That is the  
2 definition.

3 THE COURT: All right.

4 [Pause in proceedings.]

5 THE COURT: Defense costs -- as I recall the  
6 motion it's interpreted open-endedly; right? It's going  
7 forward as well? And my ruling just covered defense costs  
8 incurred today?

9 MR. GOLDMAN: Yes, Your Honor.

10 THE COURT: Okay.

11 MR. GOLDMAN: The motion defines it as the  
12 contract defines it, Your Honor.

13 MS. GILBRIDE: Your Honor, not to interrupt but  
14 does it make sense to include your order on the dismissal  
15 motion in this order as well so that for purposes of an appeal  
16 that there's one order?

17 THE COURT: No.

18 MS. GILBRIDE: Okay.

19 THE COURT: Okay. Let me tell you what I've  
20 written here because I believe this is the nature of my ruling  
21 -- and it's Paragraph 3 -- "Effective ten days after entry of  
22 this order Axis is directed upon the exhaustion of the  
23 Lexington policy to pay defense costs of movants in the  
24 underlying actions billed through the date of this order until  
25 such time" -- I'm sorry -- "pending a final determination by

1 this Court of Axis' claimed right to withhold such defense cost  
2 payments until there's a final determination of its denial of  
3 coverage under the Axis policies." Because I'm not going to be  
4 making a determination generally of coverage as this order had  
5 provided.

6 MR. GOLDMAN: So as I understand it and I believe  
7 this is what the Court had discussed, we would have a right to  
8 ask the Court to consider further defense costs presumptively  
9 on or about October 12th?

10 THE COURT: Yes, because this is just a  
11 preliminary injunction. We're going to have the final hearing  
12 -- I can't have the final hearing on October 12th.

13 MR. GOLDMAN: Yes. I do not have a problem with  
14 that language, Your Honor.

15 THE COURT: All right. So just to be clear, and I  
16 think this is important for the record, too, I will not be  
17 determining all of the issues as to whether your clients are  
18 covered for defense costs. What I am determining is whether  
19 Axis is required to advance those monies now --

20 MR. GOLDMAN: We understand that, Your Honor.

21 THE COURT: -- as opposed to their argument which  
22 is that because of the language on Page 8 that they could say  
23 these aren't "covered" and, therefore, they don't have to be  
24 advanced.

25 MR. GOLDMAN: We understand that that is the

1 dispute the Court is considering.

2 MR. EISEN: Your Honor, with the Court's leave, I  
3 will be brief. Our bills are also before Axis. As the Court  
4 knows, we joined in the motion. We do not -- I've conferred  
5 with my colleagues -- all of the indicted defendants -- the  
6 presumptively innocent defendants as Your Honor noted -- are in  
7 the most -- according to the Court's reasoning in the most --

8 THE COURT: I can't do it. I can't do it on the  
9 procedural posture that we're in. I understand logically your  
10 clients' position, but they have not a procedural setting, I  
11 believe, to seek a preliminary injunction. They haven't  
12 started an adversary proceeding, they haven't made a  
13 counterclaim. They are defendants in an adversary proceeding  
14 that I've dismissed, and they have no counterclaim that  
15 survived, because they didn't make a counterclaim.

16 MR. EISEN: Your Honor, I understand. I believe  
17 it would not be improvident, though, for the Court to issue an  
18 order that construes -- because it's the same policy at least  
19 as to the --

20 THE COURT: But orders don't do that. I'm sorry,  
21 I can't do that. I won't do that. You've heard my ruling.  
22 There are aspects of a request for a preliminary injunction  
23 that may not apply, conceivably, to your clients or to other  
24 defendants, but on the fundamental issues you've heard my  
25 ruling as to likelihood of success on the merits or the balance

1 of harms and substantial questions going to the merits and  
2 that's as far as you could tell your clients that they could  
3 have any sort of comfort at this point.

4 MR. EISEN: Your Honor, whatever the balance of  
5 harms may be as to others the assets have been frozen for the  
6 defendants.

7 THE COURT: Well, I understand, but sometimes, I  
8 think -- not sometimes, always, unless the other side is  
9 willing to waive it, and they're not waiving it and I  
10 understand why -- you have to go through the procedural hoops.

11 MR. EISEN: Thank you, Your Honor.

12 THE COURT: Okay. I've looked at the rest of the  
13 order except for a numbering problem and my inserting after  
14 "seeking reimposition of the automatic stay" in the next to the  
15 last paragraph "to the extent it applies," I don't have any  
16 other changes in it.

17 MR. GOLDMAN: Thank you, Your Honor.

18 THE COURT: Do you have a disc?

19 MR. GOLDMAN: Not with us, Your Honor.

20 THE COURT: Okay. All right. Well, then what I'd  
21 ask you to do is to e-mail what you handed me, to chambers and  
22 I'll mark it up as I read out.

23 MR. GOLDMAN: Okay. We will arrange that this  
24 afternoon.

25 THE COURT: Okay.

1 MR. GOLDMAN: Thank you very much.

2 MS. GILBRIDE: Your Honor, will we get the  
3 dismissal order this afternoon as well?

4 THE COURT: I don't know. Are you going to submit  
5 it to me?

6 MR. WALSH: We'll try, Your Honor.

7 THE COURT: Okay. If not, it will be tomorrow.  
8 It will get out very promptly.

9 MS. GILBRIDE: Okay. Thank you.

10 MR. EISEN: Your Honor, one very quick -- it's not  
11 on that motion. Not at all.

12 THE COURT: A different point? Okay. Good.

13 MR. EISEN: We had a stay motion before the Court.  
14 I believe the need for the stay motion has been obviated by  
15 the overlap.

16 THE COURT: It's moot. It's moot.

17 You're right I should have addressed that but I  
18 believe it's moot.

19 MR. EISEN: Thank you, Your Honor.

20 THE COURT: And in fact you could insert that in  
21 the dismissal motion if you want or submit your separate order  
22 on that if you wish. You could talk to Mr. Walsh about that.

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2 I certify that the foregoing is a court transcript from  
3 an electronic sound recording of the proceedings in the above-  
4 entitled matter, except where, as indicated, the Court has  
5 modified the transcript.

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9 Ruth Ann Hager

10 Dated: August 31, 2007  
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